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Supreme

Realty Associates

Edwin B. [illegible], James H. [illegible] and
Zaidenberg, as Members of the [illegible]
tive Committee,

Petitioners,

vs.

Realty Associates Securities Corporation and
Consolidated Realty Corporation,

Respondents.

PETITION OF BONDHOLDERS' PROTECTIVE COMMITTEE FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

David Saxe Rifkin, and
Bernard D. Cahn,
Counsel for Petitioners.

Julius Silver, and
Lewis, Marks & Kantor,
Attorneys for Bondholders' Protective Committee.

October 18, 1947.

The Court Press, N. Y. C.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1947.

No. .

In the Matter

of

REALTY ASSOCIATES SECURITIES CORPORATION,

Debtor.

EDWIN B. MEREDITH, JACOB R. SCHIFF and MILTON C. ZAIDENBERG, as Members of the Bondholders' Protective Committee,

Petitioners,

vs.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,

Respondents.

PETITION OF BONDHOLDERS' PROTECTIVE COMMITTEE FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Edwin B. Meredith, Jacob R. Schiff and Milton C. Zaidenberg, members of the Bondholders' Protective Committee, who have represented Bondholders throughout these proceedings, pray that a writ of certiorari be issued to review the judgment of the United States Circuit Court of Appeals for the Second

Circuit, entered July 23, 1947, modifying so much of an order of the United States District Court for the Eastern District of New York, dated August 5, 1946, as provided: (1) that the Bondholders of the Debtor should be paid interest on their claims at the rate of 6% per annum, from October 1, 1943, the date of maturity of the Bonds, to April 15, 1945, the date of payment fixed by the District Court in its order dismissing the proceeding for the reorganization of the Debtor under Chapter X of the Bankruptcy Act; and (2) that the claims upon which said interest should be paid included not only the matured principal amount of the Bonds, but also all interest accrued thereon to the maturity date.

Opinions.

The opinion of the District Court (R. 171) is reported at 66 F. Supp. 416. The opinion of the Circuit Court of Appeals (R. 209) is not yet reported.

Jurisdiction.

The judgment of the Circuit Court of Appeals was filed July 23, 1947 (R. 222). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended.

Questions Presented.

(1) Whether, in a voluntary reorganization proceeding under Chapter X of the Bankruptcy Act, instituted by a solvent debtor, the public bondholders shall receive less favorable treatment, in respect of interest accruing on their claims during the proceed-

ing, than they would receive in an ordinary bankruptcy case.

(2) Whether, during a voluntary reorganization proceeding under Chapter X of the Bankruptcy Act, instituted by a solvent debtor, interest accrues on the entire claim of the public bondholders, including in such claim the interest accrued, as well as the principal due, at the maturity date of the bonds.

(3) Whether, in such a proceeding, interest shall be paid to the debtor's public bondholders on their matured claims at the legal or judgment rate, or at a lesser rate referred to in the indenture under which the bonds are outstanding.

Statute Involved.

The pertinent provisions of the Bankruptcy Act (11 U. S. C., par. 1, *et seq.*) are set forth herein where appropriate.

Statement.

The facts in this case are not in dispute.

The Debtor, Realty Associates Securities Corporation, is incorporated and has its principal place of business in New York. It is engaged in the business of dealing in mortgages and other real estate securities and interests (R. 4-5). Its sole stockholder is Consolidated Realty Corporation (R. 7).

The principal indebtedness of the Debtor on September 28, 1943, the date of the filing of its voluntary petition for reorganization under Chapter X, was a publicly-held bond issue of which the principal amount then outstanding was $5,710,400. The bond issue

matured, without acceleration, on October 1, 1943, three days after the petition was filed (R. 6).*

The Bonds here involved were originally distributed to the public in 1925, 1927 and 1928, when the Debtor sold three bond issues of $5,000,000 principal amount each, maturing, respectively, in 1937, 1939 and 1943 (R. 5, 8). The Bonds were coupon bonds and originally bore the Debtor's unconditional obligation to pay interest at the rate of 6% per annum (R. 42, 52, 62). The Debtor filed a voluntary petition in bankruptcy on July 10, 1933, at which time an aggregate of $12,450,000 principal amount of such Bonds was outstanding (R. 5, 8). In April, 1934, the Debtor effected a composition, whereunder it made a cash payment of 15% on account of the indebtedness (including interest accrued to the date of the petition), reducing its debt to $10,598,575 (R. 5).

The adjusted principal amount was subject to a new Indenture, dated as of July 10, 1933 (R. 71), under which the maturity date of the modified bond issue was fixed as October 1, 1943 (R. 78). Interest on the adjusted Bonds was placed on an "if earned" basis, and the interest rate was reduced from 6% to 5% per annum (R. 79). Under the new Indenture, the Debtor was permitted to deduct capital losses from "earnings", for interest purposes, with the proviso, however, that such capital losses should not be deducted so as to reduce the interest to less than 3% per annum (R. 10, 94-95). Unpaid portions of

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* No point has been made by any of the parties hereto, based upon the period of three days intervening between the filing of the petition and the maturity date of the Bonds. For all practical purposes, such period will be deemed inconsequential, and the two dates will be considered as one.

the 5% annual interest obligation were made cumulative and payable out of future earnings, or at maturity (R. 10, 92-93). The 6% coupons were detached from the Bonds, which were stamped to indicate the modifications effected (R. 77).

Interest payments made after the composition and prior to the maturity of the modified Bonds approximated 3% per annum so that as of October 1, 1943, the date of maturity, there was an accumulation of unpaid interest in the amount of $1,286,646.43 (R. 147, 191). Deferment of such interest during the period from 1934 to 1943 was permitted by the unusual definition of earnings contained in the new Indenture.* During the same period, however, the Debtor repurchased $4,888,175 principal amount of the Bonds (R. 16) and, as of October 1, 1943, the principal amount outstanding was $5,710,400 (R. 6, 191).

The Debtor's petition for reorganization, dated September 28, 1943, alleged the Debtor's inability to meet its maturing indebtedness, but stated that the value of the Debtor's assets exceeded its total liabilities, including its capital stock. Debtor further alleged that its assets consisted largely of real estate and real estate securities, and that resort was made to Chapter X for a plan of reorganization which would "protect the bondholders and other creditors * * * and * * * reduce the loss to its stockholders which would otherwise result from the enforcement of bondholders' claims * * *" (R. 6).

The strenuous opposition of the Debtor to the at-

* See R. 138 for computation of earnings under the Indenture, which permitted a restricted deduction of "capital losses" and consequent reduction of interest payment, even though the Debtor's earnings were sufficient for additional interest payments.

tempts of Bondholders to protect their interests gave rise to considerable litigation in the course of the reorganization proceeding. At the instance of Bondholders, Jerome Thralls, the designee of Reconstruction Finance Corporation (which owned the stock of Debtor's sole stockholder) was removed as additional trustee (144 F. (2d) 473; cert. den. 323 U. S. 758, 89 L. Ed. 607). A Bondholders' committee friendly to the Debtor was disqualified (56 F. Supp. 1008). The Bondholders' list was freed from impoundment over the Debtor's opposition (144 F. (2d) 594), and prompt distribution to the Bondholders of large amounts of available cash was directed (58 F. Sup. 220). On April 2, 1945, the reorganization proceeding was dismissed upon motion of the Debtor and its sole stockholder, Consolidated Realty Corporation (R. 7, 25), when the latter finally advanced the funds necessary to pay the Bondholders (R. 13, 26). In their petition for dismissal, however, the Debtor and its stockholder put in issue their liability for interest beyond 5% on the unpaid principal to April 15, 1945, the date fixed for payment and settlement (R. 11, 14, 172).

The District Court's order dismissing the proceeding provided for payment of the undisputed claims for principal and interest (including interest accrued on principal during the proceeding, which was not disputed by the Debtor) and for a reserve to be retained by the Reorganization Trustees appointed under Chapter X, sufficient for payment of any additional amounts which might be allowed (R. 25-41). In dismissing the Chapter X proceeding, the District Court reserved jurisdiction to adjudicate, *inter alia*, the dispute as to the proper interest rate and the proper base upon which such interest should be paid (R. 38), the Bondholders con-

tending that interest at the rate of 6% should be allowed upon the entire claim (including in the claim interest accrued to the maturity date of the Bonds), while the Debtor contended that interest at the rate of 5% for the period of the proceeding should be paid only on the matured principal amount of the Bonds (R. 11, 14, 170).

The District Court decided that interest should be allowed at the rate of 6% on the Bondholders' entire claim, including unpaid principal and interest accrued to the date of maturity (R. 171-181, 191). The Circuit Court of Appeals reversed (Clark, *J.*, dissenting), holding, in effect, that interest at the rate of 5%, the rate referred to in the Indenture dated July 10, 1933, should be paid for the period of the proceeding and that interest at the 5% rate was payable only on that portion of the claim which represented the matured principal of the Bonds (R. 209, *et seq.*).

Specification of Errors to Be Urged.

The court below erred:

(1) in failing to allow interest on the entire claim of the Bondholders, as filed and allowed in the proceeding, including that portion of the claim representing interest accrued and unpaid at the maturity date of the Bonds;

(2) in refusing to hold that the claim of the Bondholders, as filed and allowed in the proceeding, had the efficacy of a judgment for purposes of administration under the Bankruptcy Act, and that upon such claim the legal or judgment rate of 6% was payable;

(3) in holding that the Bondholders were entitled to receive less, in respect of interest on their claims

as filed and allowed in the proceeding, than they would have received in an ordinary bankruptcy proceeding;

(4) in predicating its holdings on an interpretation of the Indenture dated July 10, 1933, and on the local law applicable thereto, rather than upon equitable considerations applicable to such matters in proceedings under the Federal Bankruptcy Act;

(5) in interpreting the said Indenture to require the payment of 5% rather than 6% interest after maturity.

Reasons for Granting the Writ.

The majority decision of the Circuit Court of Appeals below is contrary to decisions in analogous cases in this Court and in other Circuit Courts of Appeal. While the precise question here involved is one of first impression in reorganization cases under Chapter X of the Bankruptcy Act, the decisions of this Court and of Circuit Courts of Appeal, in cases arising under the ordinary bankruptcy provisions of the Act and in other analogous cases, are contrary to the holding of the Circuit Court in the instant case. As a result, the lower court's decision here will create confusion in the administration of the Bankruptcy Act and will result in less favorable treatment of creditors in Chapter X proceedings than they would receive in ordinary bankruptcy proceedings, contrary to the intention of the statute.*

The Debtor does not question that under proper equitable principles the Bondholders were entitled to interest accrued during the proceeding. The dispute here is as to the base and rate of payment. Peti-

* See Sections 102 and 200 of the Bankruptcy Act (11 U. S. C., par. 502, 600).

tioners herein contend that the Bondholders are entitled to interest based on the full amount of their allowed claims, including in such base the interest accrued at the maturity rate of their Bonds; and that interest should accrue on such claim at the legal or judgment rate of 6%. The payment of any lesser amount of interest to the Bondholders will result in a windfall to the Debtor's sole stockholder.

The contest here is between the Debtor (and its sole stockholder) and the Debtor's public Bondholders. There are no other public security holders. The reorganization petition was voluntarily filed by a solvent Debtor whose resources proved ample to make substantial payments to the Bondholders during the proceeding. The delay made possible by the proceeding during a period of rising real estate values enabled the Debtor to readjust its affairs and obtain a dismissal of the proceeding. On every important point, therefore, the facts here differ significantly from the factual situation which existed in the *Vanston* case,* where this Court decided that the equities in favor of public junior security holders rendered it inappropriate to pay full accrued interest to the senior bondholders. Further, in contradistinction to the *Vanston* case, the interest which forms part of the Bondholders' claim here, and on which interest is now sought, had accrued at the time of the filing of the Debtor's petition and not during the course of the proceeding.

Base for Interest Computation.

The holding of the Circuit Court of Appeals below that interest should be paid to the Bondholders only on that portion of their claims which represented

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* *Vanston Bondholders' Protective Committee* v. *Green, et al.*, 67 Sup. Ct. 237; 91 L. Ed. (Advance Opinions) 175 (1946).

matured principal, and not on the claim for interest accrued as of the maturity date of the Bonds, is contrary to the governing provisions of the Bankruptcy Act, and to analogous prior decisions.

Section 63(a)(1) of the Bankruptcy Act (11 U. S. C., par. 103(a)(1)) provides:

> "Debts of the bankrupt may be proved and allowed against his estate which are founded upon (1) a fixed liability as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition by or against him, whether then payable or not, *with any interest thereon which would have been recoverable at that date* * * *." (Emphasis added.)

Under a provision in the Bankruptcy Act of 1867, similar to Section 63, it was held that before any surplus could be turned over to a solvent bankrupt, interest should be paid from the date of adjudication (the date when claims were provable under the 1867 Act) to the date of payment, upon proven claims consisting of principal plus interest accrued thereon to the date of adjudication.

> *In re Town*, Fed. Cas. No. 14, 112, 24 Fed. Cas. 85 (E. D. Mich. 1873);
> *In re Hagan*, Fed. Case No. 5898, 11 Fed. Cas. 154 (S. D. N. Y., 1873).

See also:

> *In re Bank of North Carolina*, Fed. Case No. 895, 2 Fed. Cas. 667 (W. D. N. C., 1875).

In *Johnson* v. *Norris,* 190 Fed. 459 (C. C. A. 5, 1911), decided under the 1898 Bankruptcy Act, the court required the Trustee to pay interest on all approved claims from and after the date of the filing of the petition; and it appears from the case that such claims included interest to the date of the filing of the petition.

In *Ryerson and Son* v. *Peden,* 318 Ill. 105, 148 N. E. 849 (1925), which involved a claim in bankruptcy, the Illinois Supreme Court held that allowed claims which included fixed liabilities, plus interest accrued to the date of the bankruptcy petition, had the efficacy of judgments for the purpose of determining the base for the accrual of interest after the filing of the petition.

Similar principles have been applied in equity receiverships. In *Ohio Savings Bank and Trust Co.* v. *Willys Corp.,* 8 F. (2d) 463 (C. C. A. 2, 1925), the allowed claims were fixed as of April 1, 1922 (the last date for the filing of claims), and included interest accrued to that date. Interest was allowed by the court for the period subsequent to April 1, 1922, on the total amount of the claims as above computed.

Hence, under the decisions, in bankruptcy and equity receivership proceedings, allowable claims include not only matured principal but also interest thereon accrued to the date of allowance of the claims. And, in such proceedings, where the debtors are solvent, creditors are entitled to receive interest on the full amount of such allowed claims.

The term "claims", for purposes of Chapter X, is even broader than that applicable to ordinary bank-

ruptcy proceedings. Section 106 of the Act* defines the term "claims", for purposes of Chapter X, as including "all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under Section 63 of this Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent". Furthermore, the Act explicitly negatives the idea that creditors are to be treated less favorably in Chapter X than in ordinary bankruptcy proceedings. Section 200 of the Act (11 U. S. C., par. 600) provides:

> "Where not inconsistent with the provisions of this chapter, the rights, duties, and liabilities of creditors and of all other persons with respect to the property of the debtor shall be the same, before the approval of the petition, as in a bankruptcy proceeding before adjudication and, upon the approval of the petition, as in a bankruptcy proceeding upon adjudication."

No inconsistency in this case, within the meaning of the Act, precludes the application of the section. The claims of the Bondholders, as allowed by the Bankruptcy Court in the instant case, were indivisible and included interest accrued to the maturity date of the Bonds. Had this proceeding been an ordinary bankruptcy case, the Bondholders would have received interest on the full amount of their claims. The decision of the court below results in less favorable treatment of creditors in Chapter X cases, involving solvent debtors, than such creditors would receive in ordinary bankruptcy proceedings. Such a result is clearly erroneous.

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* 11 U. S. C., par. 506.

Interest Rate.

(1) The lower court was likewise in error in reducing the rate of interest allowable on the Bondholders' claims from 6% to 5%. Its decision on this point was contrary to principles established by this Court and by other Courts of Appeal.

This Court held in the *Vanston* case that the allowance by Federal courts of interest on claims against debtors' estates depends upon equitable considerations under Federal law. The touchstone of each decision in such cases is "a balance of equities between creditor and creditor or between creditors and the debtor" (91 L. Ed. Advance Opinions 179). In the instant case, the proper balance of equities between public Bondholders and the Debtor requires the payment to the Bondholders of full interest at the judgment rate.

The filing by the Debtor of its petition for reorganization was, in effect, a confession of judgment and a plea for relief against the alleged inequity to the Debtor of a forced sale of its assets. Under Chapter X, the filing of the petition prevented the Bondholders from reducing their undisputed claims to judgment. This restraint by the Bankruptcy Act was designed to prevent piecemeal disintegration of the Debtor's estate during the proceeding, and to preserve the Bankruptcy Court's control over the Debtor's entire estate, in order to assure fair and equitable treatment to all creditors. The statutory preclusion of the normal procedural remedies of Bondholders should not, however, deprive them of the substantive rights which would have attached to the entry of judgments on their Bonds. It is the intention of the statute that those substantive rights shall continue and shall be

fully recognized, with appropriate compensation for any change in position occasioned by the proceeding.

Cf. *Consolidated Rock Products Company* v. *DuBois,* 312 U. S. 510.

Where a creditor has been prevented by the filing of a reorganization petition from merging his claim for unpaid principal and interest into a single judgment debt which would bear interest at the judgment rate, he is equitably entitled to be accorded the same substantive rights as he would have possessed had the restraints of Chapter X not been imposed. His claim, when allowed, should have the same efficacy as a judgment and should occupy the same legal ground. Hence, the Bondholders' claims in the instant case are equitably entitled to be treated as judgments, and interest should be payable thereon at the rate of 6%.*

(2) The Bondholders' contention is not only grounded on general equitable principles, but is also supported by authoritative decisions in bankruptcy, receivership and liquidation cases. Such cases have consistently granted to creditors' claims the status of judgments, with full interest at the judgment rate allowable thereon, where the debtors in question were solvent or occupied comparable positions.

One of the earliest cases on the point is *National Bank of the Commonwealth of New York* v. *Mechanics National Bank,* 94 U. S. 437; 24 L. Ed. 176 (1877),

* 28 U. S. C. A., par. 811, provides that interest allowable on civil judgments shall be at the rate allowed by the laws of the state in which the Court is held. Judgments in New York bear the 6% legal rate of interest. See 19 McKinney's Consolidated Laws of New York Ann. (Gen. Bus. Law), Art. 25, par. 370.

which involved the liquidation of a bank under the National Banking Act. This Court there held that depositors were entitled to interest on demand deposits from the date of demand, at the rate applicable to judgments, stating (94 U. S. at 438-9):

> "The 50th section of the National Banking Act, 13 Stat. at L. 113, requires the Comptroller of the Currency to apply the moneys paid over to him by the receiver 'on all such claims as may have been proved to his satisfaction, or adjudicated in a court of competent jurisdiction'. The Act is silent as to interest upon the claims before or after proof or judgment. Can it be doubted that a judgment, if taken, would include interest down to the time of its rendition? Section 996 of the Revised Statutes, p. 182, declares that all judgments in the courts of the United States shall bear the same rate of interest as judgments in the courts of the States, respectively where they are rendered. Interest is allowed by the law of New York upon judgments from the time they are perfected. Rev. Code of N. Y. ed. 1859, Vol. III, p. 637.
>
> "If these claims had been put in judgment, whether in a court of the United States or in a state court of that state, the result as to interest upon the judgment would have been the same. It was unnecessary to reduce them to judgment, because they were proved to the satisfaction of the comptroller. After they were so proved, they were of the same efficacy as judgments, and occupied the same legal ground. Hence they are within the *equity* if not the letter of these statutes, and bear interest as judgments would have done * * *." (Emphasis supplied.)

Recent cases under the National Banking Act in which the same doctrine was involved include:

Stein v. *Delano,* 35 F. Supp. 260, aff'd. 121 F. (2d) 975 (C. C. A. 3, 1941), cert. den. 314 U. S. 655 (1941);

Elliott v. *First Inland National Bank of Pendleton,* 32 F. Supp. 839 (D. Ore., 1940).

The same principle was applied by the Second Circuit Court of Appeals in a bankruptcy case: *In re John Osborn's Sons & Co.,* 177 Fed. 184 (1910). In that case, the court, following the reasoning in *National Bank of the Commonwealth of New York* v. *Mechanics National Bank, supra,* concluded that "allowed claims in bankruptcy are entitled to be treated as judgments". See also *Ryerson and Son* v. *Peden,* 318 Ill. 105, 148 N. E. 849 (1925).*

The majority opinion of the Circuit Court in the instant case recognized that the doctrine in ordinary bankruptcy cases is that allowed claims are of the same efficacy as judgments. Nevertheless, the Court held that the principle is inapplicable to a Chapter X proceeding** "where the very purpose of the proceeding is to keep the debts in *statu quo* until a plan can be adopted under which the Debtor may continue in

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* While the policy of the New York courts is not controlling in these proceedings, it is relevant to note that such policy is the same. In the administration of debtors' estates, holders of matured claims are treated as judgment creditors.

Dorland v. *Fidelity Development Co.,* 104 Misc. 97, 99, 171 N. Y. Supp. 1000, 1001.

** The statutory intent, as expressed in Sections 102 and 200 of the Bankruptcy Act which apply to Chapter X proceedings the ordinary bankruptcy provisions of the Act, is contrary to the Circuit Court's conclusion.

business without having its property burdened with judgments" (R. 214). No provision of the Act or other appropriate authority is cited by the Circuit Court for that distinction, and we have been unable to find any.*

The majority opinion confuses the statutory mechanics of reorganization with the substantive rights of creditors. The mechanics of stay are essential to an orderly and effective proceeding, but the fact that creditors are stayed in the prosecution of their normal legal remedies is no basis for depriving them of a portion of the claim which they would have had but for the statutory restraints. The Circuit Court's holding is, in fact, contrary to the principle of full compensatory treatment to creditors for the sacrifices which they are required to make in Chapter X reorganization proceedings.

Consolidated Rock Products Company v. *DuBois, supra.*

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* The majority of the Court below were apparently influenced in their decision by their interpretation of the provisions of the Trust Indenture relating to the payment of interest under the laws of the State of New York. The conclusion based upon such considerations was clearly erroneous. As this Court held in the *Vanston* case [91 L. Ed. Advance Opinions 175, 178], Federal equitable principles and not local law should have governed the decision. Furthermore, it may be observed from a reading of the Circuit Court's opinion that the Trust Indenture was ambiguous in the matter of payment of interest after maturity. Under well-accepted principles of construction, such ambiguity should have been resolved in favor of the Bondholders rather than in favor of the Debtor.

Cunningham v. *Pressed Steel Car Company*, 238 App. Div. 624; aff'd. 263 N. Y. 671;
Enoch v. *Brandon*, 249 N. Y. 263, 268;
Barnes v. *United Steel Works Corpn.*, 11 N. Y. S. 2nd 161, 163.

The error in the majority's position is clearly and succinctly analyzed as follows in the dissenting opinion of Judge Clark below (R. 218-219):

> "* * * As the opinion [of the majority] substantially concedes, allowance of a claim in bankruptcy fixes it, just as does a judgment, and an ordinary judgment bears interest at the legal rate. The situation is one therefore where a debtor who has availed himself of the bankruptcy provisions ultimately is able to pay in full; he should not then be permitted to make use of the statute to reduce his claim. Obviously here, except for the proceedings, the creditors would have taken judgment at once; they should not be deprived of that advantage by the debtor's unassented-to act.
>
> "That this was a reorganization, rather than an ordinary bankruptcy, proceeding would seem not to change this situation. It is still only a question between the debtor and its creditors."

Summary and Conclusion.

The problem here is one of adjustment of equities between a solvent Debtor and its public Bondholders. The interest contended for by the Bondholders arose on a claim which was liquidated and matured at the commencement of the proceedings and included a debt for interest previously accrued. That interest accrued prior to the proceeding by reason of a definition of earnings in the Indenture which permitted the Debtor to defer payment of interest, although it had funds available for the purchase of its Bonds from the Bondholders.

On the eve of the maturity date of the principal and interest then accrued, the Debtor instituted its

second voluntary reorganization proceeding and obtained an 18-month respite, during which real estate and real estate securities appreciated substantially in value. During that period the Bondholders' funds were available to the Debtor for use in its business. Delay in payment enabled the Debtor to profit greatly by its leverage position in a rising market. Under these circumstances, it would be a gross inequity to deny to Bondholders any portion of their claims, including the interest to which they would have been entitled had the Debtor not resorted to proceedings in Chapter X.

The principles established by this Court require that creditors be paid in full for their enforced sacrifices. Not the least of the creditors' sacrifices here was their inability to realize upon their claims when due, and the consequent deprivation to them of the opportunity to benefit in a rising market. The equities clearly favor the Bondholders' contention that they should receive full payment of their claims.

Because the decision of the court below is contrary to well-established principles of bankruptcy law, and to the provisions of the Bankruptcy Act itself, and erroneously decides a question of public importance in the administration of the Act, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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October 18, 1947.

FILE COPY

Supreme Court of the

October Term,

No. 405

In the Matter

of

REALTY ASSOCIATES SECURITIES CORPORATION,

Debtor,

MANUFACTURERS TRUST COMPANY, Indenture Trustee,

Petitioner,

vs.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,

Respondents.

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Supreme Court of the United States

OCTOBER TERM, 1947.

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Respondents.

Stipulation.

IT IS HEREBY STIPULATED, CONSENTED AND AGREED that any Exhibits handed up upon the argument before the Circuit Court of Appeals, Second Circuit, pursuant to the Stipulations appearing at pages 200, 203 and 205 of the Transcript of Record used in that Court, may be included as appendices to any brief presented to the Supreme Court of the United States upon the application for writ of certiorari to review the judgment of said Circuit Court dated July 23, 1947, and in event

writ is granted, may be included in the transcript of record on appeal to the Supreme Court.

Dated: New York, N. Y., September 26th, 1947.

NEWMAN & BISCO,
Newman & Bisco, Attorneys for
Manufacturers Trust Company.

GEORGE ZOLOTAR,
George Zolotar, Attorney for
Securities & Exchange
Commission.

ROOT, BALLANTINE, HARLAN, BUSHBY
& PALMER,
Root, Ballantine, Harlan, Bushby
& Palmer, Attorneys for Con-
solidated Realty Corporation.

HOOKER, ALLEY & DUNCAN,
Hooker, Alley & Duncan,
Attorneys for the Debtor.

United States Circuit Court of Appeals
FOR THE SECOND CIRCUIT.

In the Matter
of
REALTY ASSOCIATES SECURITIES CORPORATION,
Debtor.

In the Matter of the Determination of the Amount of Interest Payable in Respect of the Debtor's Bonds After Maturity.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,
Appellants.

Complete Petition of Debtor Under Chapter X, Without Attached Exhibits (Only Part of Which Appears in Record, Fols. 12-20), Referred to in Brief of Appellees Manufacturers Trust Company, the Indenture Trustee, and Parties in the Armed Services.

HANDED UP AT THE ARGUMENT, PURSUANT TO STIPULATION (fol. 614).

PETITION OF DEBTOR UNDER BANKRUPTCY ACT, CHAPTER X.

[Without attached exhibits.]

(No. 45024)

(In Proceedings for the Reorganization of a Corporation.)

To the Honorable Judges of the District Court of the United States for the Eastern District of New York:

The petition of Realty Associates Securities Corporation respectfully represents:

1. Your petitioner is a corporation organized and existing under the laws of the State of New York and is a corporation which could become a bankrupt under the Act of Congress Relating to Bankruptcy, and is not a municipal, insurance or banking corporation or a building and loan association, or a railroad corporation authorized to file a petition under Section 77 of said Act.

Your petitioner now has and for more than ten years next preceding the filing of this petition has had its principal office and place of business at No. 162 Remsen Street, in the Borough of Brooklyn, County of Kings and State of New York, within the territorial jurisdiction of this Court.

2. The nature of the business of your petitioner is to buy, sell, administer and deal generally in mortgages and real estate securities and real property acquired by reason thereof and in interests or estates therein, and to make mortgage loans to and enter into contracts and agreements with builders, property owners, and others.

3. That on July 10, 1933, your petitioner filed a voluntary petition in bankruptcy in this Court, and thereafter offered terms of composition dated October 26, 1933, to its creditors, affecting particularly its three bond issues of 1925, 1927 and 1928, each originally in principal amount of $5,000,000 and maturing respectively July 1, 1937, December 1, 1939 and October 1, 1943; that said terms of composition were accepted by the creditors of your petitioner, and pursuant thereto, an Indenture, dated as of the 10th day

of July, 1933, was made between your petitioner and Manufacturers Trust Company, as Trustee, under which the bonded debt of your petitioner then in principal amount $12,450,000 was reduced to $10,598,575, with interest cumulative at the rate of five per cent per annum from July 10, 1933, and the maturity date for all of the bonds fixed as October 1, 1943; that under said Indenture your petitioner was not set up as a liquidating company but was authorized to do new business and permitted to acquire bonds and mortgages maturing five years later than its bonds, or October 1, 1948; that since the execution and delivery of said Indenture, your petitioner has operated and conducted its business and affairs in accordance with and subject to the provisions of said Indenture; that interest on said bonds at the rate of five per cent per annum, cumulative, has been payable solely out of earnings, and during that time, petitioner has paid approximately three per cent per annum interest to bondholders, and approximately two per cent interest per annum has accumulated; that your petitioner's financial condition and the character of its assets have been greatly improved despite the depression, mortgage moratorium laws and generally unfavorable conditions existing in the real estate field during the past ten years; that petitioner has acquired by purchase and now holds in its treasury its own bonds in the principal amount of $4,888,175, and its remaining bonds now outstanding are in unpaid principal amount of $5,710,400, with accumulated and unpaid interest thereon from July 10, 1933 to April 10, 1943, amounting to $1,167,679.76. These bonds mature October 1, 1943, at which time the accumulated unpaid interest becomes due and payable with the principal. There is not now and there has been no default on said bonds or under said Indenture. Petitioner has no other obligations except current bills.

4. Your petitioner is unable to pay its debts as they mature.

5. The assets, liabilities, capital stock and financial condition of your petitioner as of June 30, 1943 are as follows:

Petition.

BALANCE SHEET, JUNE 30, 1943

Assets

Cash in banks		$1,108,737.63
Legal investments at book value (quoted market value $1,760,069.00)		1,793,192.15
Miscellaneous investments at book value:		
Bonds and mortgage certificates	$ 879,853.29	
Capital stocks of affiliated corporations	6,050.00	
		885,903.29
Notes Receivable		22,453.67
Accounts receivable		23,964.12
Bonds and mortgages receivable—Principal outstanding		4,164,751.46
Installment contracts receivable—Principal outstanding	$ 300,976.19	
Less—Principal amount of mortgages on properties sold under installment contracts	88,417.59	
		212,558.60
Advances made for mortgagors and purchasers under installment contracts	1,483.06	
Less—Reserve for uncollectible accounts	857.58	
		625.48
Real estate, carried at book value	7,475,871.52	
Less—Principal amount of mortgage liens thereon	5,895,558.12	
		1,580,313.40

Other investments:		
Realty Associates Securities Corporation 5% stamped bonds due 1943 in the principal amount of $4,888,175.00, at cost	2,178,044.13	
Securities purchased with funds that were part of the $23,801.23 reserve, per contra, for losses on mortgages purchased guaranteed, at cost	19,944.59	
		2,197,988.72
Investments in capital stocks of wholly-owned corporations		166,330.11
Deferred charges and items held in suspense		6,900.20
Total Assets		$12,163,718.83
Deficit (based on book values and subject to note below):		
Operating deficit, beginning July 10, 1933	$1,624,864.20	
Less—Paid-in surplus	323,108.03	
		1,301,756.17
		$13,465,475.00

LIABILITIES

Accounts payable:		
Collections made by corporation as agent	$ 19,083.57	
Coupons payable on old bonds $1,758.00		
Less—Funds with paying agent 1,626.00		
	132.00	
Miscellaneous	2,868.18	
		$22,083.75

Interest payable on 5% stamped bonds due October 1, 1943, issued or to be issued (see note):		
Accumulated and accrued interest	2,414,528.55	
Less—Excess cash on deposit with Trustee	73.34	
	2,414,455.21	
Less—Cash on deposit with Trustee for interest distributable to bondholders July 1, 1943	158,978.63	
		2,255,476.58
Liability for 5% stamped bonds due October 1, 1943:		
Bonds issued (including $4,888,175.00 of bonds acquired by the corporation at a cost of $2,178,044.13—see contra)	10,551,400.00	
Bonds to be issued for old 6% bonds which have not yet been presented to the Trustee for reduction and modification	47,175.00	
		10,598,575.00
Principal amount of old 6% bonds uncancelled	162,525.00	
Less—Principal amount of bonds on hand with corporation and trustee, to be used, if necessary, as explained in the attached report (accountant's report)	162,525.00	
		* * *
Deferred credits and items held in suspense:		
Unearned discounts on mortgages and installment contracts	560,276.48	

Deposits on leases and sales	1,590.00	
Unrealized income, unapplied collections of mortgage principal, and other items held in suspense	2,171.96	
		564,038.44
Reserve for losses on certain mortgages purchased guaranteed ($19,944.59 of this reserve has been invested in securities—see contra)		23,801.23
Capital stock (authorized and issued): 300 shares of no par value—Declared value of $5.00 per share		1,500.00
		$13,465,475.00

NOTE: The accumulated and accrued interest payable aggregating $2,414,528.55 includes $1,113,606.12 which is applicable to the $4,888,175.00 of bonds owned by the corporation and held as investments at June 30, 1943. This interest receivable of $1,113,606.12 has not been set up in the books, as the bonds to which it relates are income bonds, and such interest, therefore, would not be received (or the liability cancelled) by the corporation until maturity (unless the bonds were cancelled), in which case the relative amount of accrued interest receivable on such cancelled bonds would offset a corresponding amount of the interest payable set up in the books. As the bonds are traded in at a flat price, if the corporation should sell any of them the subsequent owners would normally receive all of the interest, when, as, and if paid. No part of the above-mentioned interest receivable of $1,113,606.12 has been reflected in this or any of the statements contained in the report.

The foregoing balance sheet is the latest available and taken from the Report on Audit and Accounts for the three months ended June 30, 1943, made by Stagg, Mather & Hough, of 141 Broadway, New York City, who are independent public accountants selected in accordance with the

provisions of said Indenture, dated as of July 10, 1933, and approved by Manufacturers Trust Company, Trustee under said Indenture, and by the four representatives on the Board of Directors of your petitioner selected by the bondholders pursuant to said Indenture, and the said Report on Audit and Accounts, including said balance sheet, is on file with the said Trustee and is subject to the comments contained in said Report.

The said bonds shown on said balance sheet in principal amount $4,888,175, which the Corporation acquired by purchase, are held in the treasury of your petitioner ready and available for cancellation in conjunction with a plan of reorganization; and, upon such cancellation, the above stated deficit (based on book values) shown on said balance sheet in amount $1,301,756.17 will be changed into a surplus (based on book values) of $2,521,980.82 thereby more clearly showing the financial condition of your petitioner.

It is believed that, as at the date of the verification of this petition, the figures above set forth in the balance sheet remain substantially the same, except as the balance sheet changes to reflect the transaction of your petitioner's business and affairs in the ordinary course of business subsequent to the date thereof, and that the accrued interest on funded debt has increased by lapse of the intervening time, and the petitioner's cash on hand and in banks is at present approximately $1,261,000.00.

6. The nature of all pending proceedings affecting the property of the Corporation known to your petitioner, and the courts in which they are pending, are set out in detail in Exhibit "A" annexed hereto and made a part hereof. An examination of this exhibit reveals that these proceedings consist largely of mortgage foreclosure or certiorari proceedings.

7. No plan of reorganization, readjustment or liquidation affecting the property of your petitioner is pending in connection with any judicial proceeding. A voluntary Plan for Reduction and Extension of your petitioner's bonds was formulated and sent to all bondholders on July 30, 1943, as more completely set forth in the following paragraph.

8. The specific facts showing petitioner's need for relief under Chapter X of said Act are as follows: Your petitioner's assets are of a value in excess of its total liabilities

inclusive of its capital stock but the nature of its assets, being in large part real estate and real estate securities, is such that their true value is not readily realizable; a forced sale of said assets would bring substantially less than their true value and under existing war time conditions and by reason of the moratorium statutes of the State of New York, might bring even less than its total liabilities exclusive of its capital stock; your petitioner's financial condition and situation is such that insistence by its bondholders upon payment of their bonds in full at maturity, October 1, 1943, would lead to many actions and proceedings against it, recovery of judgments against it, levy of execution against its assets, interference with and destruction of its business and property, with resulting loss to creditors and destruction of rights of stockholders. The adoption of a suitable plan of reorganization under said Act will protect the bondholders and other creditors of your petitioner and will reduce the loss to its stockholders which would otherwise result from the enforcement of bondholders' claims and consequent destruction of your petitioner's business and sacrifice and loss in the value of its properties. It is essential for the protection of creditors and stockholders that the commencement of suits against your petitioner be stayed pending final decree in this proceeding.

Your petitioner prepared and on July 30, 1943 forwarded to all bondholders of record a "Plan for Reduction and Extension of the Bonds of Realty Associates Securities Corporation, maturing October 1, 1943", a copy of which is annexed hereto, made a part hereof and marked Exhibit "B".

In substance, said Plan provides for cancellation and retirement of all bonds owned by your petitioner, together with accumulated interest thereon, a payment of fifteen percent of the principal amount of each remaining outstanding bond upon the Plan becoming effective, a payment of twenty-five percent of the accumulated interest to bondholders upon the Plan becoming effective and payment of the balance in three annual installments, the extension of the maturity date of the bonds as so reduced to October 1, 1953, and modification of the interest rate and a change in the method of computing earnings from which the interest, a part of which was to be based on earnings, was to be paid. A proposed Supplemental Indenture, dated as of October 1, 1943, was prepared, embodying in detail the

changes contemplated by the said Plan in the aforesaid Indenture, dated as of July 10, 1933, and containing provisions for the protection of bondholders in accord with the Trust Indenture Act of 1939, and said Indenture and Supplemental Indenture were duly qualified with the Securities and Exchange Commission by its order dated July 21, 1943.

At the date of the verification of this petition, 1,450 bondholders holding in the aggregate $3,601,950, of the principal amount of bonds outstanding (excluding the bonds owned by your petitioner) have signified in writing their assent to said Plan. In addition, holders of a large amount of bonds have stated that they favor said Plan provided all bondholders receive the same treatment. It is therefore believed that a plan of reorganization can speedily be worked out under the supervision and protection of the Court, thereby preventing possible partial loss to petitioner's creditors and heavy loss to its stockholders.

The specific facts showing why adequate relief cannot be obtained under Chapter XI of said Act are as follows: Because of the large unpaid principal amount of bonds outstanding, $5,710,400 (which is exclusive of bonds owned by petitioner), and the large number of bondholders, approximately 2,300, your petitioner may not resort to the ordinary form of arrangement with its bondholders under Chapter XI of said Act and the Plan which has been prepared does not lend itself for treatment under said Chapter XI of said Act.

9. Your petitioner desires that a plan or reorganization be effected for it under and pursuant to Chapter X of said Act.

10. The indebtedness of your petitioner, liquidated as to amount and not contingent as to liability, is over $250,000, and a trustee is to be appointed under Chapter X of the Bankruptcy Act who shall be disinterested. Petitioner desires that, for the purposes specified in Section 189 of the Bankruptcy Act, an additional trustee be appointed, and desires that such additional trustee be Jerome Thralls, who has been a director of your petitioner for eight years and is thoroughly familiar with its business and affairs.

11. This petition is filed in good faith; and in view of the response of petitioner's bondholders in a period of only

two months to the aforesaid Plan for Reduction and Extension of its Bonds, referred to in more detail in paragraph "8" above, it is not unreasonable to expect that a plan of reorganization of the petitioner can be effected.

12. No other petition by or against your petitioner is pending under Chapter X of said Act, nor is any other bankruptcy proceeding initiated by a petition by or against your petitioner now pending.

13. The stock of your petitioner and the stock of Realty Associates, Inc., a corporation organized and existing under the laws of the State of New York, which is the owner of and engaged in the development, management and operation of real property, is owned by the same stockholder, Consolidated Realty Corporation, a corporation organized and existing under the laws of the State of New York, having its principal place of business at No. 33 Liberty Street, New York City. For many years, your petitioner and Realty Associates, Inc. have had and maintained and now do have and maintain joint offices at No. 162 Remsen Street, Brooklyn, New York, and their officers and employees have been and now are almost identical; and these companies, through their association, have each enjoyed substantial savings in overhead costs and substantial financial benefits. The directors of your petitioner, four of whom are designated by bondholders, and the directors of Realty Associates, Inc. have from time to time apportioned between the two companies the salaries and wages of their officers and employees in accord with their judgment as to the proper allocation thereof based upon the services rendered by the officers and employees to each of the companies. At present your petitioner is defraying 67½ percent of the salaries and wages of the officers and employees of the two companies and Realty Associates, Inc. is defraying 32½ percent of such salaries and wages. Your petitioner believes that proportion now is the fair and reasonable apportionment of such costs between the companies. In the interest of sound, efficient operation and administration of the business and assets of your petitioner, petitioner asks that such arrangement be continued until otherwise ordered by this Court. (For the year 1942, this apportionment was 70 percent to your petitioner and 30 percent to Realty Associates, Inc.)

Petition.

14. Petitioner desires that until the qualification of such trustee and additional trustee as may be appointed, or until further order of the Court, petitioner be authorized to continue the employment of its officers, as set forth in the affidavit filed herein pursuant to Bankruptcy Rule X-3 of this Court, at the rates of compensation therein set forth, and on the basis of apportionment outlined in paragraph "13" above and to continue to operate and maintain its property and business, to pay salaries, wages, carrying charges and other expenses of operation and maintenance of its property and business as they mature and, if applicable, on the basis of apportionment outlined in paragraph "13" above, to pay current accounts payable for wages and other expenses of operation and maintenance of its property and business, to continue performance of its existing contracts for the purchase or sale of bonds and mortgages and real estate, and its other contracts and agreements including the agreement for apportionment of salaries and wages outlined in paragraph "13" above, and to take any and all other action deemed necessary to continue the operation and maintenance of its property and business. The payroll for the officers and office employees, consisting of about 68 persons, and for the employees in buildings owned by petitioner, consisting of about 10 persons, and any other classes of employees, is paid weekly, semimonthly and monthly. Your petitioner believes that failure to meet such costs, expenses, charges and payroll promptly might seriously disrupt and injure petitioner's business.

15. The Board of Directors of the petitioner duly authorized and directed the filing of this petition by resolutions duly adopted at a meeting of said Board of Directors held September 28, 1943, a copy of which resolutions, certified by the Secretary of the petitioner, is annexed hereto, marked Exhibit "C", and made a part hereof.

WHEREFORE, your petitioner prays

(a) That an order be entered herein approving this petition as properly filed under said Chapter X;

(b) That Jerome Thralls be appointed an additional trustee for the purposes specified in Section 189 of the Bankruptcy Act;

(c) That the petitioner be authorized, until further order of the Court or until further action by any trustee appointed herein, to continue the employment of its officers as set forth in the affidavit filed herein pursuant to Bankruptcy Rule X-3 of this Court, at the rates of compensation in said affidavit set forth and on the basis of apportionment outlined in paragraph "13" herein;

(d) That the petitioner be authorized, until the qualification of a trustee appointed herein, to operate and maintain its property and business, to pay salaries, wages, carrying charges and other expenses of operation and maintenance of its property and business as they mature and, if applicable, on the basis of apportionment outlined in paragraph "13" herein, to pay current accounts payable for wages and other expenses of operation and maintenance of its property and business, to continue performance of its existing contracts for the purchase or sale of bonds and mortgages or real estate, and its other contracts and agreements including the agreement for apportionment of salaries and wages outlined in paragraph "13" herein, and to take any and all other action deemed necessary to continue the operation and maintenance of its property and business;

(e) That a plan of reorganization of the petitioner be effected pursuant to Chapter X of the Bankruptcy Act, and that your petitioner be granted all other and further relief to which it may be entitled.

REALTY ASSOCIATES SECURITIES CORPORATION
By: Harry D. Burchell
Vice-President of said Corporation
Petitioner.

Vincent Rowan
Treasurer of said Corporation,
Petitioner.

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE SECOND CIRCUIT

In the Matter

of

REALTY ASSOCIATES SECURITIES CORPORATION,

Debtor.

In the Matter of the Determination of the Amount of Interest Payable in Respect of the Debtor's Bonds After Maturity.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,

Appellants.

I, ALEXANDER M. BELL, Clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby certify that the attached was used on the argument of the above entitled case in this court.

ALEXANDER M. BELL
Clerk

by A. DANIEL FUSARO
Deputy Clerk

Dated: August 28, 1947

United States Circuit Court of Appeals
FOR THE SECOND CIRCUIT.

In the Matter

of

REALTY ASSOCIATES SECURITIES CORPORATION,
Debtor.

In the Matter of the Determination of the Amount of Interest Payable in Respect of the Debtor's Bonds after Maturity

MANUFACTURERS TRUST COMPANY,
Appellant.

EXHIBITS #4 AND #5 REFERRED TO AT PAGE 21 OF APPELLANT'S BRIEF.

HANDED UP AT THE ARGUMENT, PURSUANT TO STIPULATION (fol. 614).

Exhibit #4.

At Brooklyn, New York, in the said Eastern District of New York, on the 15th day of June, 1944.

This cause coming on further to be heard upon the order to show cause granted herein May 26, 1944, upon the petition of HUNTER L. DELATOUR and RAYMOND REISLER, Esqs., verified the 26th day of May, 1944 and the affidavit of JEROME THRALLS, Esq., sworn to the 26th day of May, 1944, for instructions regarding the making of a further payment to the bondholders of the outstanding bonds of the Debtor,

Now, upon reading the order to show cause granted herein May 26, 1944, together with the petition of HUNTER L. DELATOUR, Esq., and RAYMOND REISLER, Esq., verified the 26th day of May, 1944, and the affidavit of JEROME THRALLS, sworn to the 26th day of May, 1944, upon which said order to show cause was granted, and upon reading the notice of motion of LEWIS, MARKS & KANTER and JULIUS SILVER, attorneys for Bondholders' Protective Committee, dated June 7, 1944, and the affidavit of EDWARD B. MEREDITH, sworn to the 8th day of June, 1944; the notice of motion of ARCHIBALD PALMER, attorney for Anna A. Kuhlmann and Catherine Kuhlmann, bondholders, together with the petition of said Anna A. Kuhlmann and Catherine Kuhlmann, verified the 5th day of June, 1944; and the notice of motion of JOSEPH R. MARGULIES, attorney for bondholders, Ernestine Needles, et al., dated June 7, 1944, all submitted in connection herewith; and after hearing HALPIN and KEOGH, Esqs., attorneys for the Trustees herein (by Eugene J. Keogh, of counsel); ARCHIBALD PALMER, attorney for Anna A. Kuhlmann and Catherine Kuhlmann, bondholders; LEWIS, MARKS & KANTER and JULIUS SILVER, Esqs., attorneys for Bondholders' Protective Committee (Jack L. Rappaport, Esq., of counsel); GEORGE ZOLOTAR, Esq., attorney for Securities and Exchange Commission; JOSEPH R. MARGULIES, attor-

ney for Ernestine Needles, et al.; HERRICK and FEINSTEIN, Esqs., attorneys for Bondholders' Directors Committee (Abraham Feinstein, Esq., of counsel); CHARLES J. BUCHNER, Esq., attorney for M. C. O'Neill, bondholder; NEWMAN & BISCO, Esqs., attorneys for the Indenture Trustee and for the bondholders serving in the armed forces (Perry A. Hull, Esq., of counsel); ROOT, CLARK, BUCKNER and BALLANTINE, Esqs., attorneys for Consolidated Realty Corporation (William P. Palmer, Esq., of counsel); HOOKER, ALLEY and DUNCAN, Esqs., attorneys for the Debtor (James B. Alley, Esq., of counsel); PERCIVAL E. JACKSON, attorney for John Vanneck, et al., and the court having reserved decision with respect to the making of any payment on account of the unpaid principal of the outstanding bonds of the Debtor and no objection having been made to the payment by the Trustees herein of interest on said bonds

NOW, upon motion of HALPIN and KEOGH, attorneys for the Trustees herein, it is

ORDERED that said application be and the same hereby is granted to the extent that HUNTER L. DELATOUR and RAYMOND REISLER, as Trustees, and JEROME THRALLS, as additional Trustee, be and they hereby are authorized and permitted to make a payment of interest at the rate of 3% per annum on July 1, 1944, to all the holders of the outstanding stamped bonds of the Debtor, and it is further

ORDERED that the said Trustees and additional Trustee may employ a paying or disbursing agent for the purpose of preparing, drawing and mailing the checks in payment of the interest above provided and may pay such agent a sum not to exceed Three hundred seventy-five ($375) Dollars, for its fees for such services, plus its actual disbursements for printing, stationery and postage at cost.

GROVER M. MOSCOWITZ,
United States District Judge.

Exhibit #5.

HUNTER L. DELATOUR, Esq., and RAYMOND REISLER, Esq., as Trustees of Realty Associates Securities Corporation, Debtor, having moved this Court for an order authorizing and permitting the said Trustees to make a payment of interest for the period of six months from May 1, 1944 to October 31, 1944, at the rate of 3% per annum, on January 1, 1945, to all the holders of outstanding stamped bonds of the Debtor, and such motion having duly come on to be heard on December 15, 1944,

Now, on reading and filing the petition of Hunter L. Delatour, Esq., and Raymond Reisler, Esq., verified December 8, 1944, in support of said motion; the order to show cause dated December 8, 1944 with proof of due service thereof upon the attorneys for all interested parties who have appeared herein, and after hearing HALPIN & KEOGH, attorneys for the Trustees, by Edward S. St. John, Esq., of counsel, in support of said motion, and after hearing George Zolotar, Esq., attorney for Securities and Exchange Commission, in favor of payment of interest for such period at the rate of 5% per annum; Lewis, Marks & Kanter, and Julius Silver, Esq., attorneys for Bondholders' Protective Committee, by Lloyd B. Kanter, Esq., of counsel, in favor of payment of interest for such period at the rate of 5% or 6% per annum; and Joseph R. Margulies, Esq., attorney for Bondholders Ernestine Needles, et al., in support of the payment of interest for such period at the rate of 6% per annum; Hooker, Alley & Duncan, attorneys for the Debtor, by James B. Alley, Esq., of counsel, in support of payment of interest for such period at the rate of 3% per annum and in opposition to payment at a higher rate; and Percival E. Jackson, Esq., attorney for Bondholders John Vanneck, et al., by Theodore N. Tarlau, Esq., of counsel; Newman & Bisco, attorneys for Manufacturers Trust Company as Indenture Trustee and for persons in the Mili-

tary Service, by Perry A. Hull, Esq., of counsel; Root, Clark, Buckner & Ballantine, attorneys for Consolidated Realty Corporation, by William P. Palmer, Esq., and L. Robert Driver, Esq., of counsel; Arthur O. Asher, Esq., attorney for Max L. Bliss, et al., bondholders; Irving L. Schanzer, Esq., attorney for Prudence Realization Corporation; James A. Dealy, Esq., attorney for Amalgamated Properties, Inc.; Lynn G. Goodnough, Esq., attorney for Realty Associates, Inc.; Chester Allen, Esq., attorney for Kings County Trust Company, appearing but not opposing, and due deliberation having been had,

Now, on motion of Halpin & Keogh, attorneys for the Trustees, it is

Ordered that the said motion be and the same hereby is granted to the extent of authorizing and directing Hunter L. Delatour, Esq., and Raymond Reisler, Esq., as Trustees of Realty Associates Securities Corporation, Debtor, on January 1, 1945, to make a payment of interest at the rate of 5% per annum for the period from May 1, 1944 to October 31, 1944, to all the holders of outstanding stamped bonds of the Debtor, and it is further

Ordered that the said Trustees may employ a paying or disbursing agent for the purpose of preparing, drawing and mailing the checks in payment of the interest so provided, and may pay such agent a sum not to exceed the sum of $375 for its fees, for such services, plus its actual disbursements for printing, stationery and postage at cost.

Dated: Brooklyn, New York, December 21st, 1944.

G. M. MOSKOWITZ,
United States District Judge.

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE SECOND CIRCUIT

In the Matter

of

REALTY ASSOCIATES SECURITIES CORPORATION,

Debtor.

In the Matter of the Determination of the Amount of Interest Payable in Respect of the Debtor's Bonds after Maturity

---

MANUFACTURERS TRUST COMPANY,

Appellant.

I, ALEXANDER M. BELL, Clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby certify that the attached was used on the argument of the above entitled case in this Court.

ALEXANDER M. BELL
Clerk

by A. DANIEL FUSARO
Deputy Clerk

Dated: September 4, 1947.

(Seal)

FILE COPY

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FILED
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CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

October Term, 1947

In the Matter of

REALTY ASSOCIATES SECURITIES CORPORATION,
Debtor.

No. 405

MANUFACTURERS TRUST COMPANY, Indenture Trustee,
Petitioner,

v.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,
Respondents.

No. 406

EDWIN B. MEREDITH, JACOB R. SCHIFF and MILTON C. ZAIDENBERG, as Members of the Bondholders' Protective Committee,
Petitioners,

v.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,
Respondents.

No. 407

VANNECK REALTY CORPORATION,
Petitioner,

v.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,
Respondents.

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION IN SUPPORT OF PETITIONS

Legal Intelligencer, 1218 Chestnut St., Phila. 7, Pa.

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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1947

In the Matter of

REALTY ASSOCIATES SECURITIES CORPORATION,
Debtor.

No. 405

MANUFACTURERS TRUST COMPANY,
Indenture Trustee, *Petitioner,*

v.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,
Respondents.

No. 406

EDWIN B. MEREDITH, JACOB R. SCHIFF and MILTON C. ZAIDENBERG, as Members of the Bondholders' Protective Committee, *Petitioners,*

v.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,
Respondents.

No. 407

VANNECK REALTY CORPORATION,
Petitioner,

v.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,
Respondents.

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION IN SUPPORT OF PETITIONS

The respondent Consolidated Realty Corporation is a corporation all of whose stock is owned by the Reconstruction Finance Corporation. Consolidated Realty Corporation, in turn, owns all of the stock of the debtor, Realty Associates Securities Corporation. The Securities and Exchange Commission is a statutory party herein pursuant to Section 208 of the Bankruptcy Act, 11 U.S.C. § 608, and its position in the instant matter in support of the petitions for certiorari is contrary to that of the Reconstruction Finance Corporation. In view of the conflicting positions of these two governmental agencies, I am authorizing each to present a brief in its own name. *Cf. Consolidated Realty Corp.* v. *Meredith, et al.*, 323 U.S. 758 (1944).

PHILIP B. PERLMAN,
Solicitor General.

OPINIONS BELOW

The opinion of the District Court (R. 171) is reported at 66 F. Supp. 416. The opinion of the Circuit Court of Appeals (R. 209), modifying the order of the District Court, is reported at 163 F. 2d 387.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 23, 1947 (R. 222). The petitions for writs of certiorari were filed on October 20, 1947. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, 28 U.S.C. §347(a), and Section 24(c) of the Bankruptcy Act, as amended, 11 U.S.C. §47(c).

QUESTIONS PRESENTED

(1) Whether the substantive rights of creditors to accrue interest on their claims are less in a Chapter X reorganization than in straight bankruptcy?

(2) Whether creditors holding matured and undisputed claims against the debtor on the date of a voluntary Chapter X petition, which claims consist of unpaid principal and interest, and which were prevented from being reduced to judgment by the debtor's resort to Chapter X, are entitled as against a sole stockholder upon dismissal of the proceedings and the return of the properties to the solvent debtor (a) to interest on the entire amount of their claims, including that portion representing interest accrued prior to the filing of the petition, and (b) to accrue such interest as may be allowed at the rate applicable to judgments rather than the contract rate.

STATEMENT OF FACTS

The debtor, Realty Associates Securities Corporation, deals in mortgages and other real estate interests (R. 4-5) and the respondent, Consolidated Realty Corporation, is its sole stockholder (R. 7). The Chapter X petition was filed by the debtor on September 28, 1943 in contemplation of the imminent maturity of a large publicly held bond issue due three days later, October 1, 1943 (R. 6). This was the principal (and practically the sole) indebtedness of the debtor, and its petition alleged that while the value of its assets exceeded "total liabilities inclusive of its capital stock," a forced sale might bring in less than the true value of the assets to the detriment of the stockholder interests (R. 6).

The bonds were originally issued in three series of $5,000,000 each in 1925, 1927, and 1928, due 1937, 1939, and 1943, respectively (R. 5; 8), and bore unconditional rights to 6% interest semi-annually (R. 42; 52; 62). On July 10, 1933, when some $12,450,000 principal amount was still outstanding, the debtor filed a voluntary petition in bankruptcy (R. 5; 8). The bankruptcy proceeding was terminated the following year as the result of a composition effected by the debtor. The composition involved a 15% payment on account of the outstanding indebtedness, an

extension of the remaining debt (including all three bond issues) to October 1, 1943, and a reduction in the interest rate thereon from 6% unconditionally to 5% "if earned." (R. 78). An amended indenture, dated as of July 10, 1933, defined "earnings" for interest purposes to permit deductions of capital losses provided that such losses could not be used to reduce interest below 3% per annum (R. 78; 92). Unpaid portions of the 5% annual interest were made cumulative and payable out of future earnings, or unconditionally at maturity (R. 10; 92). As a result, instead of being wiped out by bankruptcy, the debtor obtained a ten year moratorium which included substantial alleviation of its interest obligation.

During the moratorium years which followed, the debtor paid approximately 3% per annum, and took advantage of the unique definition of earnings to defer the remainder, thus retaining for its own use money which otherwise would have been payable to the bondholders.[1] As the extended maturity date approached, the debtor found itself still owing $5,710,400 in unpaid principal (R. 6; 191) and $1,286,646.43 in unpaid interest (R. 5; 10; 191). According to the Chapter X petition, it then had assets with a book value of nearly $13,500,000 (App.[2] b4), including approximately $1,261,000 in cash. (App. b7) and $1,760,069 in readily marketable securities (App. b3). Despite the availability of liquid assets more than sufficient to satisfy all interest claims, no payment of these claims was proffered. Instead, the debtor first attempted, in July of 1943, to obtain another voluntary extension and composition of the indebtedness and, failing in this, resorted to Chapter X to stave off the enforcement remedies normally available to the bondholders.

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[1] See Statement of Earnings for the Six Months Ending April 30, 1943 (R. 138), for an illustration of the deduction of capital losses.

[2] "App." refers to the Appendices to Petitioners' Brief in No. 405, Filed Pursuant to Stipulation Dated September 26, 1947.

The Chapter X proceeding lasted nearly 18 months and was dismissed on April 2, 1945 on the petition of the debtor and its sole stockholder, Consolidated Realty Corporation (R. 7, 25). By that time the debtor's business situation and the value of its assets had improved sufficiently to persuade the stockholder respondent to advance it the funds necessary to discharge the indebtedness. The petition for dismissal, however, denied any liability for interest beyond 5% on the unpaid principal to April 15, 1945, the date fixed for payment and settlement (R. 26; 172). The court's dismissal order, provided for payment of the undisputed claims for principal and interest, and for a reserve to be retained by the Chapter X trustees sufficient to pay any additional amounts which might be allowed (R. 26 *et seq.*). Jurisdiction was reserved to adjudicate, *inter alia*, the dispute as to the proper interest rate and base, the specific issues with respect thereto being:

(1) Whether interest is payable after the institution of the Chapter X proceedings on that portion of the bondholders' claims which represented unpaid interest accrued prior to that date; and

(2) Whether interest on the bonds, matured as of October 1, 1943, accrued during the Chapter X proceedings at the rate of 5%, as the debtor and its sole stockholder contend is provided by the indenture, or at 6%, the judgment rate which the bondholders contend should equitably be applied since they were prevented from obtaining judgment by the debtor's petition for reorganization.

The District Court held that the bondholders were entitled to 6% judgment interest on their entire claim including unpaid principal and interest accrued to the date of maturity and the filing of the Chapter X petition [3] (R.

[3] Throughout these proceedings the date of the Chapter X petition and the maturity date of the bonds have been treated essentially as one; for, as previously noted, the petition was

171-181; 191). On appeal by the debtor and its sole stockholder, a majority of the Circuit Court of Appeals (Judges Swan and Learned Hand), construed the indenture as providing for a 5% rate of interest on the unpaid principal of the bonds after maturity,[4] and held that interest was payable at that rate and only upon the portion of the bondholders' claim which represented unpaid principal (R. 217). The judgment of the District Court was modified accordingly (R. 218). Judge Clark, dissenting, expressed the view that equitable considerations required the allowance of the 6% judgment rate of interest on the bondholders' entire claim, including interest accrued prior to the abortive Chapter X proceeding (R. 218).[5] The instant petitions for certiorari followed.

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filed only three days earlier and admittedly in contemplation of the imminent maturity of the bonds.

[4] While we believe that the indenture, properly construed, does not contain any applicable post-maturity rate of interest on the bonds and that, therefore, they bear the legal rate of interest after maturity, we do not press at this time our disagreement with the decision of the court below on this point. This interpretative issue is of no significance if petitioners are correct in contending that interest should be allowed on their claims as if they had been reduced to judgment.

[5] The Indenture Trustee had also appealed from another portion of the District Court's order which applied an interim payment first towards reduction of the bondholders' original claim, rather than upon the interest which had accrued during the course of the Chapter X proceedings (R. 191; 197). The Circuit Court found that such application produced a difference in the amount to which the bondholders were entitled only if more than 5% interest were payable, and in view of its holding as to the proper interest rate and base, regarded this aspect of the appeal as academic. Accordingly, this portion of the District Court's order was affirmed (R. 218).

ARGUMENT

The petitions present questions of importance in the administration of Chapter X of the Bankruptcy Act which we believe should be decided by this Court. The rights of creditors holding matured and undisputed claims against a debtor to accrue interest on those claims from the date of the petition at the rate applicable to judgments where, but for the petition, they would be entitled to reduce those claims to judgment and receive interest thereon at the judgment rate, is a federal question which, in the context of a reorganization proceeding, has not been, but should in our opinion be, considered by this Court. Improved business conditions and appreciations in asset realization values during the past few years have provided surpluses after payment of the principal of creditors' claims in many estates being administered under Chapter X, with resultant conflict between creditors and stockholders as to the validity and extent of the interest claims payable out of such surpluses. Thus, the question here presented is of recurrent importance under present business conditions.[6] We believe it was erroneously decided by the majority of the court below. In our opinion, the decision below introduces novel distinctions between allowable claims in straight bankruptcy and in Chapter X reorganizations which are unwarranted by the provisions and underlying purposes of the Bankruptcy Act. The determination below also runs counter to well established equitable doctrines applicable in federal liquidation and reorganization proceedings.

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[6] For example, aspects of this problem have recently been presented in the following reorganizations in which the Commission is a party: *In re Childs Company*, 69 F. Supp. 856 (S.D.N.Y. 1946), and S.E.C. Corp. Reorg. Release No. 67, C.C.H. Bankruptcy Law Service, par. 55,734; *In re United States Realty & Improvement Co.*, S.D.N.Y., Bkcy. No. 83280, order approving plan dated May 14, 1946, par. 18; *In re Equitable Office Bldg. Corp.*, S.D.N.Y. Bkcy. No. 78476, order approving plan dated October 24, 1947, appeals pending in the court below.

1. As previously noted, the decision below introduces a distinction between the allowable claims of creditors in straight bankruptcy and in Chapter X reorganization which is wholly unwarranted by the statute. The court below expressly recognizes that "allowed claims in bankruptcy are of the same efficacy as judgments with respect to bearing interest, where the assets of the bankrupt are sufficient" (R. 214). It had expressly so held in *In re John Osborn's Sons & Co.*, 177 Fed. 184 (1910),[7] a straight bankruptcy case, relying upon the ruling of this Court in *National Bank of the Commonwealth of New York* v. *Mechanics National Bank*, 94 U.S. 437 (1876). The latter case involved the liquidation of a New York bank under the National Banking Act [8] and the depositors were held to be entitled to interest on demand deposits from the date of demand at the rate applicable to judgments in the State of New York. This Court then stated (94 U.S., at 439):

> "If these claims had been put in judgment * * * the result as to interest upon the judgment would have been the same. It was unnecessary to reduce them to judgment, because they were proved to the satisfaction of the comptroller. After they were so proved, they were of the same efficacy as judgments, and occupied the same legal ground."

Insofar as the decision below treats the principal amount of the bonds as differing from the accrued interest as respects its status as an interest bearing claim, the decision is contrary to Section 63(a)(1) of the Act, 11 U.S.C.

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[7] Appellants in the court below attempted to distinguish the *Osborn* case because of the failure of the bankrupt in that case to make any contract for the payment of interest. The court below stated, however (R. 214): "Assuming without decision that the attempted distinction would be invalid in an ordinary bankruptcy, we are not convinced that the 'judgment theory' is applicable in a Chapter X reorganization. . . ."

[8] Recently, in *Vanston Bondholders' Protective Committee* v. *Green et al.*, 329 U.S. 156 at 165 (1946), in dealing with a specialized interest problem in a Chapter X proceeding, this Court referred to bank liquidation cases as involving analogous principles.

§ 103(a) (1), which is applicable to a Chapter X proceeding as well as an ordinary bankruptcy, and which provides that an allowable claim shall include a fixed liability of the debtor, together with any interest thereon which would have been recoverable at the date of the petition. Under this provision principal and interest accrued to the date of the petition are treated as part of the creditor's single claim against the estate, just as they would be treated as a single claim if reduced to judgment. Thus, in *Johnson* v. *Norris*, 190 Fed. 459 (1911), the Fifth Circuit Court of Appeals ruled that interest was payable on claims which, as filed, included interest accrued prior to the date of the bankruptcy petition, before any part of a surplus held by the trustee could be turned over to the bankrupt.[9] In the present case, at the date of the Chapter X petition the bondholders' claim against the debtor amounted to $6,997,046.43, of which $1,286,646.43 represented interest accrued and accumulated prior to the Chapter X proceedings. Contrary to the statute, the holding below denies the creditor the full right to treat the accrued interest as part of his claim for the purpose of an allowance of interest.

The majority of the Circuit Court of Appeals differentiated straight bankruptcy from reorganization, and decided that, in the latter proceeding, creditors possessing matured and undisputed claims which would have been reduced to judgment but for the Chapter X petition, were not entitled to have their claims for principal and accrued interest treated as if reduced to judgment because, in the majority's view, Chapter X contemplates a "moratorium" for the debtor precluding the recognition of those claims as "peremptory demands, like judgments, upon which dam-

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[9] In *Ohio Savings Bank & Trust Co.* v. *Willys Corp.*, 8 F. 2d 463 (1925), the court below, in an equity receivership proceeding, applied the same theory in allowing interest on creditors' claims, part of which had represented interest accrued prior to the institution of the proceedings.

ages in the form of interest for delay in payment" is payable (R. 214).[10]

The attempted differentiation is apparently predicated upon the assumption, a fallacious one as we show below, that the greater remedial restrictions imposed by Chapter X in the interest of facilitating reorganization, require a holding that the claims of creditors in Chapter X are less than in straight bankruptcy. On the contrary, Section 200 (11 U.S.C. §600) provides that the rights of creditors with respect to the property of the debtor shall be the same in Chapter X as in straight bankruptcy unless "inconsistent with the provisions of this chapter"; and there are no provisions which would indicate that the substantive claims of creditors are less in Chapter X than in straight bankruptcy. If anything, they may be greater: See *e.g.*, the broad definition of "claims" in Chapter X which is set forth in Section 106(1), 11 U.S.C. §506(1).[11] So far as we know, this purported distinction, which conflicts with basic provisions of the Bankruptcy Act and runs counter to its underlying policy, is made for the first time by the court below.

2. Apart from the express statutory mandate that the substantive rights of creditors in Chapter X shall conform

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[10] The decision below does not push the concept of moratorium to the point of disallowing as between creditors and the debtor any "damages in the form of interest," a result recognized to be contrary to settled authority. Instead, that portion of the claim which represents accrued interest, assumed to be a non-interest bearing claim under local law unless reduced to judgment, was continued as a non-interest bearing claim and the bondholders were allowed 5% interest on the unpaid principal, which the court below held to be the post-maturity interest rate provided by the indenture. See pages 12-17, *infra*, where we discuss the inequity of the concept of moratorium so applied.

[11] Section 106(1) provides that claims recognizable in Chapter X include "all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under Section 63 of the Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent."

to those in ordinary bankruptcy, there are other important reasons why the substantive scope of a creditor's claim should not depend on whether Chapter X or straight bankruptcy is invoked. Thus, we believe that the choice of proceedings should depend upon the prospects of realizing or preserving through reorganization, values for the totality of interests affected which might be lost in a straight bankruptcy proceeding. However, if the amount of the creditor's claim which will be recognized is less in a Chapter X proceeding than in ordinary bankruptcy, basically irrelevant considerations will be introduced which will tend to intensify conflicts of interest between different classes of security holders as respects the appropriate choice of proceeding. In a case, such as the instant one, involving a controversy between a single class of creditors and the stockholder interests, the decision below can only have the effect of stimulating creditor opposition to the reorganization process.

The decision below also creates certain other difficulties in the administration of the Bankruptcy Act. For example, Section 238(1), 11 U.S.C. § 638(1), provides that where a Chapter X proceeding is ultimately converted into a straight bankruptcy liquidation, the proceeding shall be conducted so far as possible in the same manner and with like effect as if an involuntary petition in bankruptcy had been filed at the date of the Chapter X petition and a decree of adjudication entered when the Chapter X petition was approved. It would seem to follow from the doctrine enunciated by the majority of the court below that although judgment interest would be denied during the Chapter X "moratorium", it would be required to be allowed retroactively to the date of the original reorganization petition in the event that the proceedings were transferred to straight bankruptcy. It hardly needs to be emphasized that a creditor's substantive rights should not be based upon such a contingency.

Again, the determination below would afford an inequitable advantage to certain creditors in a case where,

because of special circumstances unrelated to the propriety of preferential treatment of their claims, these creditors were permitted by the Chapter X court to pursue their claims to judgments after the filing of the petition.[12] In the event that there are assets available for the payment of interest on allowed claims, the ruling below would require that interest be payable on the newly acquired judgments at the judgment rate while other creditors are relegated to the contract rate, which may be considerably lower. A similar situation would be presented had the instant petition been filed after the maturity date of the bonds (instead of before) and had some of the bondholders succeeded in obtaining judgments on their claims prior to the petition. The inequality which would result were the "moratorium" concept of the court below applied in these situations obviously conflicts with the underlying statutory policy of equality of distribution.[13]

3. In developing its concept of a "moratorium" purpose of Chapter X the court below misconceived the purpose of the restraints which Chapter X imposes upon the entry of judgments and introduced an arbitrary rule in conflict with the flexible equitable considerations governing the allowance of interest claims which this Court so clearly enun-

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[12] The fact that a stay of lawsuits against the debtor rests in the discretion of the reorganization court and is not mandatory under the statute [see Sections 57d, 113, 116(4), 11 U.S.C. §§ 93a, 513, 516(4)] negates the "moratorium" concept of the court below as a statutory prohibition against judgments and their incidents after institution of reorganization proceedings, including the accrual of interest on claims as if they had been reduced to judgment.

[13] Section 63(a)(5) of the Act, 11 U.S.C. § 103(a)(5), for example, endeavors to preserve the statutory policy of equality of distribution among creditors by providing that where claims are permitted to be reduced to judgment after the filing of a petition, costs and interest accrued between the date of the petition and the entry of judgment shall not be allowed as part of the creditor's allowable claim; but this does not destroy its status as a judgment.

ciated in *Vanston Bondholders Protective Committee* v. *Green*, 329 U.S. 156 (1946).

The purpose of the customary stay of action which the reorganization court has discretion to grant is to avoid a race of the diligent to obtain preferential access to the assets, to insure equality of treatment among creditors, to prevent piecemeal executions, and to provide an orderly and equitable liquidation or reorganization. The normal procedural remedies are thus rendered unavailable, but the purpose of this restraint does not include denial of the substantive rights to which creditors would have been entitled absent the statutory proceedings. As the court below recognizes, at least as regards a straight bankruptcy proceeding, those substantive rights include judgment rights to interest where the entry of judgment has been precluded by the institution of proceedings under the Bankruptcy Act. The greater restrictions imposed by Chapter X upon the exercise of normal creditor remedies, we believe, do not warrant diminution of the allowable claims of creditors in a reorganization under that Chapter. On the contrary, those added restrictions and the slower process of realizing upon a claim in Chapter X make it all the more imperative that the substantive rights of creditors be fully protected in the reorganization process.

The reasoning of the majority below that Chapter X contemplates a "moratorium" which precludes alteration of the contractual relationship between the debtor and its creditors prior to the effective date of a plan overlooks the fact that the contract dealt with would be incomprehensible unless negotiated with reference to the creditor's expectations of obtaining judgment rights. The contract itself provided for a 10-year moratorium of limited scope, including a reduction in the contract rate of interest from 6% to 5% together with contingent provisions for deferring the interest claim to maturity. Regardless of the dispute as to whether the modified contract should be construed as continuing interest at 5% after maturity in the absence of

action by bondholders to enforce their claims, it is inconceivable that bondholders would have consented to the composition had they understood that the debtor could by institution of reorganization proceedings obtain a further moratorium in which the accumulated arrears of interest would be treated as a non-interest bearing claim and the return on principal would continue reduced below the judgment rate.

In denying interest on that part of the bondholders' claim which represented prior unpaid interest, the majority below relied largely upon a local New York policy against the compounding of interest, a policy which it conceded would be inapplicable if the claims were treated as if merged into judgment (R. 217).[14] The court below, however, refused to treat the indebtedness at the date of the petition as a single interest bearing claim. In our view, the holding below is contrary to the provisions of Section 63(a)(1) of the Bankruptcy Act, discussed *supra*, pp. 8-9, and, in addition, contravenes the equitable considerations which this Court, in the *Vanston* case, *supra*, held applicable as respects the allowance of interest in a Chapter X reorganization to the exclusion of any rules under state law.

In the *Vanston* case, which involved a Chapter X reorganization, this Court pointed out that "the touchstone of each decision on an allowance of interest in bankruptcy and receivership has been a balance of equities between creditor and creditor, or between the creditors and the debtor" (329 U.S., at 165). "Where an estate (is) ample to pay all creditors and pay interest even after the petition was filed," this Court observed, "equitable considerations (are) invoked to permit payment of this interest to * * * creditor(s) rather than to the debtor" (329 U.S., at 164). While the actual holding in the *Vanston* case was to deny interest on interest coupons which had matured after the institution of reorganization proceedings, and which were

[14] See also the New York cases cited *infra* n. 16, which treat allowed claims in local insolvency proceedings as if merged into judgments.

left unpaid in consequence of restraints imposed in the course of judicial administration, this interest denial was based solely upon a merging of the equities as between the classes of security holders affected. The estate was insolvent and the proceedings had extended over a period of sixteen years—from equity receivership, to Section 77B, and eventually into Chapter X. The accruals of interest on the overdue coupons were so large that they ate deeply into assets which otherwise would have been available to the junior creditors. To have allowed this additional interest on interest would have enriched the first mortgage bondholders at the expense of the junior creditors whose equity in the estate would have been seriously diminished by the protraction of the proceedings. In effect, allowance of the interest sought by the first mortgage bondholders would have placed upon the junior creditors the expense of a reorganization instituted for the benefit of all creditors.

A similar equitable approach was taken by the court below in the railroad reorganization case of *In re New York, New Haven & Hartford R.R.*, 147 F. 2d 40 (1945), *cert. denied*, 325 U.S. 884 (1945), in which a secured creditor had been enjoined from realizing on pledged collateral at a time when it had substantial market value. By the time the reorganization plan was approved the collateral had become worthless. Under these circumstances the court below held (147 F. 2d, at 48) :

> "*The damage to the banks resulting from it (the injunction) ought not equitably to be saddled on them but on the parties for whose supposed benefit the restraint was imposed, and particularly is this true where the decline in the value of the collateral resulted from an act of the debtor itself.* In our opinion fair and equitable treatment requires that the damage caused the banks should be made good to them and that they should be classified as secured creditors to the extent to which they could have realized on their collateral had they not been restrained from selling . . ." (Italics supplied.)

Analogous principles have been applied in other federal liquidations and reorganizations,[15] and, although not controlling in these proceedings, the New York courts give effect to the same equitable considerations in insolvency proceedings.[16]

The instant controversy presents the converse of the *Vanston* case and involves considerations resembling those present in the *New York, New Haven & Hartford R.R.* case. We believe that the equitable doctrines there enunciated require denial of the windfall which the debtor's sole stockholder would reap if the bondholders' matured and undisputed claims were not treated as if merged into judgment. As the reorganization petition substantially admits, the proceedings were instituted for the purpose of safeguarding the stockholder's equity in the debtor's assets, and were dismissed only after the debtor's financial condition had improved sufficiently to warrant that stockholder in advancing funds to discharge the debt. In depriving the bondholders of all rights to interest on a substantial part of their claim which was reducible to judgment at the date of the petition, and in denying them the judgment rate of interest on the balance, a rate to which they would have

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[15] Thus, in *Bindseil* v. *Liberty Trust Co.*, 248 Fed. 112 (1917) in holding that rents and profits belonged ultimately to a mortgagee who was restrained by the bankruptcy court from collecting them pending bankruptcy, the Third Circuit Court of Appeals observed (248 Fed., at 115): "As we are dealing in this case with the equitable administration of bankrupt assets, where creditors' *legal rights are preserved but where their legal remedies are lost and equitable remedies are substituted, equity requires the new remedies to be as effective as the old in protecting and enforcing such rights.*" (Italics supplied.)

See also, *Associated Co.* v. *Greenhut*, 66 F. 2d 428 (C.C.A. 3, 1933), *cert. denied*, 290 U.S. 696 (1933); *In re Wakey*, 50 F. 2d 869 (C.C.A. 7, 1931); *Mortgage Loan Co.* v. *Livingston*, 45 F. 2d 28 (C.C.A. 8, 1930); *In re Torchia*, 188 Fed. 207, 208-209 (C.C.A. 3, 1911).

[16] See *e.g.*, *Dorland* v. *Fidelity Development Co.*, 104 Misc. 97, 99, 171 N.Y. Supp. 1000, 1001 (N.Y. Sup. Ct. 1918); *Skilton* v. *Cordington*, 185 N.Y. 80, 87, 77 N.E. 790, 792 (1906); *Hunting v. Blun*, 143 N.Y. 511, 38 N.E. 716 (1894); *Lang v. Lutz*, 180 N.Y. 254, 260, 73 N.E. 24, 26 (1905).

been entitled absent the abortive Chapter X proceeding, the holding below saddles the creditors with the burden of a reorganization instituted for the benefit of the debtor and its sole stockholder.

We note, in passing, the reliance placed by the majority below upon a number of cases in which the Interstate Commerce Commission and federal courts have approved plans of reorganization which contained provisions for the accrual of interest at the contract rate subsequent to the date of the reorganization petition. As the majority below concedes (R. 214-5), it does not appear that the question as to the proper rate of interest was ever raised or considered in those cases. The opinions and available financial manuals indicate that with one exception [17] those cases all involved claims whose normal maturity dates did not arrive until well after the petition for reorganization,[18] so that the equitable considerations for treating them as if reduced to judgment would appear to be lacking.[19] These cases, moreover, did not deny creditors the right to interest on a claim which was reducible to judgment at the date of the institution of Chapter X proceedings. In view of these circumstances, we do not believe that they are of any value as precedents in the instant controversy.

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[17] *In re Adolf Gobel, Inc.*, Bankruptcy No. 79,526, S.D. N.Y., plan approved June 1, 1944.

[18] Such were the facts in *Ecker* v. *Western Pacific R.R. Corp.*, 318 U.S. 448 (1943); *Brooks* v. *St. Louis-San Francisco Ry.*, 153 F. 2d 312 (C.C.A. 8, 1946), *cert. denied*, 328 U.S. 868 (1946); *Chicago, Rock Island & Pacific Railway Reorganization*, 254 I.C.C. 707 (1943); *In re McKesson & Robbins, Inc.*, 8 S.E.C. 853 (1941), cited by the court below.

[19] We do not urge that a claim which would normally mature after the Chapter X petition is entitled to judgment interest from the date of the petition. In our view, the contract interest governs to the date of normal maturity and, in the case of an undisputed claim, judgment interest thereafter. We do not argue for the allowance of judgment interest as of the date of an accelerated maturity caused by the institution of receivership or reorganization proceedings, since this acceleration may be regarded as a penalty which, under the *Vanston* case, should not be permitted to flow from the institution of such proceedings.

Supreme Court of the United States

OCTOBER TERM, 1947.

Nos. 405, 406, 407.

IN THE MATTER

of

REALTY ASSOCIATES SECURITIES CORPORATION,
Debtor.

MANUFACTURERS TRUST COMPANY, Indenture Trustee,
Petitioner,

vs.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,
Respondents.

EDWIN B. MEREDITH, JACOB R. SCHIFF and MILTON C. ZAIDENBERG, as Members of the Bondholders' Protective Committee,
Petitioners,

vs.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,
Respondents.

VANNECK REALTY CORPORATION,
Petitioner,

vs.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,
Respondents.

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

FILED
NOV 18 1947

BRIEF IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI.

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Reconstruction Finance Corporation, the holder of all the capital stock of the Respondent, Consolidated Realty Corporation.

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OCTOBER TERM, 1947.

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EDWIN B. MEREDITH, JACOB R. SCHIFF and MILTON C. ZAIDENBERG, as Members of the Bondholders' Protective Committee,

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REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,

Respondents.

BRIEF IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI.

Statement by the Solicitor General.

The respondent Consolidated Realty Corporation is a corporation all of whose stock is owned by Reconstruction Finance Corporation. Consolidated, in turn, now owns all of the stock of Realty Associates Security Corporation.

The Securities and Exchange Commission is a statutory party to the case, pursuant to 11 U. S. C. Section 608. The Commission has taken a position contrary to that of the Reconstruction Finance Corporation. In view of the conflicting positions of the two governmental agencies, I am authorizing each to present a brief in its own name. *Cf. Consolidated Realty Corp.* v. *Meredith, et al.*, 323 U. S. 758.

PHILIP B. PERLMAN,
Solicitor General.

Preliminary Statement.

This brief is submitted on behalf of Realty Associates Securities Corporation (the Debtor) and Consolidated Realty Corporation (sole stockholder of the Debtor) in opposition to three petitions for writs of certiorari filed by the Bondholders' Protective Committee, Manufacturers Trust Company, and Vanneck Realty Corporation to review the judgment of the United States Circuit Court of Appeals for the Second Circuit, entered on July 23, 1947. Such judgment modified an order of the United States District Court for the Eastern District of New York, entered on August 5, 1946 in the reorganization proceeding of the Debtor under Chapter X of the Bankruptcy Act.*

Opinions Below.

The opinion of the Circuit Court of Appeals (R. 209-219) is reported at 163 F. (2d) 387. The opinion of the District Court (R. 171-181) is reported at 66 F. Supp. 416.

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* The three petitions and briefs of the petitioners are referred to herein as "Committee Petition", "Manufacturers Petition" and "Vanneck Petition". The Securities and Exchange Commission has also filed a brief in this matter which is herein referred to as the "SEC Brief".

Jurisdiction.

The petitioners have invoked the jurisdiction of this Court under Section 24(c) of the Bankruptcy Act (11 U. S. C. §47(c)) and under Section 240(a) of the Judicial Code (28 U. S. C., §347(a)).

Statement of the Case.

On September 28, 1943, when the Debtor filed its petition for reorganization under Chapter X, the Debtor was not in default in any way. On the maturity date of its bonds (October 1, 1943) the stay provided pursuant to Chapter X suspended the Debtor's obligation of prompt payment of the principal of the bonds and of interest thereon which had accrued prior to the Chapter X petition but which did not become due until after the petition.

The Debtor remained in reorganization until April, 1945, when it became possible to pay its bondholders. At that time, the respondents did not deny that interest had continued to run on the Debtor's bonds during the period of the proceeding; the bondholders were paid all of the unpaid principal of their bonds, all of the unpaid pre-maturity interest which had become due during the proceeding, and interest at the 5% contract rate on the principal of the bonds for the entire post-maturity period down to the date of actual payment. The bondholders contended, however, that they were entitled to added compensation for the delay occasioned by the Chapter X proceeding; they claimed that they were entitled to the legal rate of interest, which is greater than the applicable contract rate, and to interest on the pre-maturity interest which became due and payable during the proceeding, but which was not paid on its due date because of the pending proceeding.

The respondents have contested the bondholders' asserted right to such added compensation.

Questions Presented.

The petitions present the following questions:

1. If bonds provide that interest shall be paid after their maturity date at the rate of 5% and the bonds mature during a Chapter X proceeding, is interest on such bonds after maturity to be computed at the 5% contract rate or the 6% legal rate?

2. If bonds contain no provision for the payment of interest on unpaid interest, and such bonds mature on a date during a Chapter X proceeding, at which maturity date all accumulated, accrued interest becomes payable, is interest payable on the accumulated interest from the date the accumulated interest was payable until it is paid?

The Court below held (1) that interest ran throughout the proceeding, both before and after maturity, at the 5% contract rate; and (2) that no interest was payable upon the accumulated interest which became due and payable during the Chapter X proceeding.

Reasons for Denying the Writs.

The respondents submit that, as to both questions, none of the petitions raises any question which warrants review by this Court, for the following reasons:

1. The sole basis for the petitioners' assertion that they are entitled to the legal rate of interest and to interest on interest is an alleged "judgment theory", which presents no problem of importance, because such theory is opposed by:

(a) The decision of this Court in *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156 (1946), reh. den. 329 U. S. 833 (1947);

(b) The uniform practice of this Court and other federal courts in the computation of claims in Chapter X, Section 77B and Section 77 proceedings;

(c) The absence, not only of any conflict in the Circuit Courts of Appeal, but also of any bankruptcy, Chapter X, Section 77B or Section 77 case supporting the petitioners' "judgment theory";

(d) The purpose of Chapter X.

2. The petitions present no question regarding any provision of the Bankruptcy Act and the Circuit Court's decision is in complete harmony with the purpose of Chapter X.

3. The petitioners' assertion that the Court below has not properly construed the contract as to the post-maturity interest rate does not present a question of a character calling for decision by this Court.

Argument.

1. The "judgment theory" asserted by the petitioners raises no question for review by this Court.

The petitioners argue that, irrespective of the bondholders' rights under their contract, they had a right to the 6% legal rate after maturity both on the principal and on the accrued pre-maturity interest. The petitioners assert that there is a rule of law, applicable in Chapter X proceedings, which cuts across the provisions of the contract and entitles bondholders to the legal rate of interest after maturity (despite the contract specification of a lower rate) and also entitles them to interest on interest which became due during the proceeding but which was not paid on its due date.

The rule of law asserted by the petitioners is that an allowed creditor's claim in a Chapter X proceeding is, in effect, a "judgment" for the entire amount of the claim (*i.e.*, principal and all interest accrued before the Chapter X petition) which "judgment" bears interest at the legal rate from the date of the Chapter X petition or, in any case, from the date when the claim became payable by its terms. A variant of this theory is the petitioners' contention that the bondholders have sustained a "loss" as a result of the delay in collecting upon their bonds as each bondholder could, in the absence of the Chapter X proceeding, have obtained a judgment at maturity (October 1, 1943) for the principal amount of his bond and for all the accumulated interest which then became due. Each such judgment would have borne interest at the legal rate from the time it was entered and the bondholders assert that they are equitably entitled to be placed in as good a position as if the Chapter X proceeding had not stayed their immediate remedies.

The Court below decided that there is no such rule of law as the petitioners urge. Such decision is in accord with all of the pertinent decisions of this Court and the other federal courts and does not warrant review. There is no provision in Chapter X (or in any other part of the Bankruptcy Act) embodying such rule of law or in any way in conflict with the Circuit Court's decision. Not a single reorganization case has been cited by the petitioners in which the "judgment theory" has been adopted to produce the results they urge here. The uniform practice of the Courts, in computing claims in reorganization proceedings, stands opposed to the "judgment theory". And the recent decision of this Court in the *Vanston* case (*supra*, p. 4) is directly opposed to the petitioners.

A. The petitioners' "judgment theory" is directly opposed by this Court's decision in *Vanston Bondholders Protective Committee* v. *Green*.

The decision of this Court in *Vanston Bondholders Protective Committee* v. *Green* (*supra*, p. 4) is squarely opposed to the petitioners' "judgment theory" and leaves no question that a review of this case is unwarranted as to either the rate of interest question or the interest-on-interest question.

The facts of the *Vanston* case can be summarized as follows:

The equity receivership of Inland Gas Corporation began on December 2, 1930. No interest coupons on the Inland bonds were in default at that time, but default was later made in payment of the February 1, 1931 semi-annual interest coupon, which included interest accrued in respect of the four months before the start of the equity receivership. On April 3, 1931, the Indenture Trustee for the Inland bonds declared the entire principal immediately due and payable. In 1935 a creditors' petition for reorganization of Inland under Section 77B was approved, and at a later date the reorganization was continued as a Chapter X proceeding.

In 1938 the principal of the Inland bonds matured by their terms and remained unpaid. In 1943 a bondholders' committee petitioned for a cash distribution on the Inland bonds, and the Chapter X trustee asked the District Court whether the Inland bondholders were entitled to interest on their interest coupons from their due dates to the date of payment as expressly provided in the Inland indenture. The February 1, 1931 and all of the subsequently maturing interest coupons to and including the normal maturity date of the bonds in 1938 had remained unpaid. The security for the Inland bonds was adequate

to cover principal, the unpaid interest coupons, and interest on the principal and such coupons. It was conceded "that the first mortgage bondholders should receive simple interest on the principal due them", but there was a challenge to the Inland bondholders' "right to be paid interest on interest which fell due after the court took charge of Inland and which interest the Court * * * directed the receiver not to pay on the due date"*; as pointed out above, the interest on which interest was claimed included four months' interest which had accrued prior to the date of the equity receivership and several years' interest which had accrued and become payable prior to the Section 77B proceeding.

This Court (speaking through Mr. Justice Black) said that, when Inland went into receivership, the "obligation to make prompt payment of simple interest coupons was suspended," and pointed out that the "extra interest covenant may be deemed added compensation for the creditor, or, what is more likely, something like a penalty to induce prompt payment of simple interest."** This Court rejected the claim for interest on interest, holding that "legal suspension of an obligation to pay is an adequate reason why no added compensation or penalty should be enforced for failure to pay."***

The facts which were before this Court in the *Vanston* case are, in every material respect, identical with the facts in this *Realty Associates* case. The result in the *Vanston* case demonstrates that creditors are not entitled to be treated, under the circumstances of this *Realty Associates*

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* 329 U. S. at 159. The Record on Appeal in the *Vanston* case shows that the stay in the equity receivership was not materially different from the Chapter X stay in this *Realty Associates* case.

** 329 U. S. at 166.

*** 329 U. S. at 166-167.

case, as if they had obtained "judgments"; it demonstrates that the Court below was entirely correct in rejecting the petitioners' claim to such treatment. The holding in the *Vanston* case, although directed only to the interest-on-interest question, is equally opposed to the petitioners' contention that the allowance of a claim in a bankruptcy or Chapter X proceeding is a "judgment" for the purpose of raising the rate of interest.

If the petitioners' "judgment theory" were the law, the Inland bondholders would have been entitled to be treated as if they had obtained a "judgment" (for principal and all accrued interest) at the start of the equity receivership in 1930, or (if the "judgment theory" is mandatory under the Bankruptcy Act) at the start of the 77B proceeding in 1935. But the Inland bondholders were not treated as if they had obtained a judgment at either of these times. The petitioners' theory that a claim is "judgment" as of the date of the petition, when tested against the *Vanston* decision, is wrong.

But for the stay of the reorganization proceeding, the Inland bondholders could, at the normal maturity of their bonds in 1938, have sued for judgments for principal and all of the interest which had become payable between 1930 and 1938 and collected legal interest on such judgment. But this Court denied the Inland bondholders any interest at all on the long overdue interest. This Court refused to accord to the Inland bondholders any "judgment rights" either as of the date of the receivership or the Section 77B proceeding, or as of the "normal maturity" date of their bonds, which the petitioners in this *Realty Associates* case contend is required both by statute and judicial precedent.

The petitioners argue that this Court's refusal to give effect to a contract provision for the payment of interest on interest in the *Vanston* case warrants disregard of the

contract in this *Realty Associates* case. Their argument ignores the reasoning in the *Vanston* case. The reason that this Court refused to enforce a contract right to interest on interest was that the delay in payment was essential to administration of the debtor's estate for the benefit of all parties — secured creditors, unsecured creditors and the debtor. It is patent that this reason for disregarding a contract so as to deny interest on interest does not warrant the allowance of such interest when not contracted for or the increase of the contract rate of interest to the legal rate. Because the equitable powers of a Bankruptcy Court may be used to deny recognition of a right under a contract to "added compensation" does not mean that such powers are to be used to grant such a right when it does not exist either under the contract or applicable State law.

The petitioners assert that the *Vanston* case is distinguishable from this *Realty Associates* case because the former involved conflicting equities of two classes of creditors, whereas in this case the conflict is between creditors and the Debtor.* The *Vanston* opinion shows that such difference, if it existed, would be immaterial. The Inland bondholders' security was sufficient to pay them in full (including interest on interest) and they had undisputed priority over the subordinate creditors participating in the reorganization. The Inland bondholders were as fully entitled to "absolute priority" over the unsecured creditors in that proceeding as the *Realty Associates* bondholders are to "absolute priority" over the stockholders; the Inland bondholders had a right to be compensated for every cent of interest which was legally owing to them even if this left nothing for junior creditors. *Consolidated Rock Products Co.* v. *DuBois,* 312 U. S. 510, 527 (1941); *Group of Institu-*

* SEC Brief, pp. 14-16; Committee Petition, p. 9; Manufacturers Petition 25, 34-35.

tional Investors v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Co.*, 318 U. S. 523, 546 (1943). Every equitable consideration in favor of a creditor against a stockholder is equally applicable in favor of a fully secured creditor against a junior creditor. And the *Vanston* decision shows that the "absolute priority" of senior parties over junior parties in a reorganization does not extend to "judgment rights".

Further, the denial of the petition for rehearing by this Court in the *Vanston* case shows that the factual distinction which the petitioners assert does not exist. It was pointed out to the Court in such petition that the facts warranted the conclusion "that there are now assets sufficient, if its [the Court's] decision stands, to make a payment on the stock of the Debtor".* Despite such a showing, this Court denied the petition for rehearing, confirming the conclusion to be derived from its original opinion that it did not intend to limit the denial of interest-on-interest to cases involving insolvent debtors.

The petitioners also try to escape the rule of the *Vanston* case on the ground that the interest on which interest was sought had accrued in the *Vanston* case during the reorganization proceeding, whereas substantially all the interest in this *Realty Associates* case accrued (although it did not become due) prior to the reorganization proceeding.** But as pointed out above (pp. 7-8), a large part of the interest in the *Vanston* case had accrued and become payable prior to the statutory reorganization proceeding under Section 77B and Chapter X; and four months' interest represented by the February 1, 1931 coupon accrued prior to

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* Page 3 of the Petition for Rehearing in the *Vanston* case filed January 3, 1947.

** SEC Brief, pp. 14-16; Committee Petition, p. 9; Manufacturers Petition, p. 13.

the original equity receivership although such interest, like the accumulated interest in this *Realty Associates* case, did not become payable until after the proceeding had started.

Further, the petitioners' argument ignores the reasoning of this Court in the *Vanston* case which demonstrates that the crux of the matter is not the period in respect of which the interest accrued, but the time when it fell due and the reason it was not paid when due. If the reason was that a Chapter X proceeding was pending (legally suspending payment of the interest on the due date), then, under the *Vanston* case, interest is not allowed for the delay in the payment. That was true in the *Vanston* case and is equally true in this *Realty Associates* case.

The petitioners also assert this *Realty Associates* case differs from the *Vanston* case because the Chapter X petition here was a voluntary petition.* This attempted distinction, too, is without validity. Chapter X was made available by Congress to petitioning debtors as well as petitioning creditors. To hold that one rule of law is applicable if the petition is voluntary, and another rule if involuntary, would be unworkable and would negate the very purpose of Congress in permitting debtors to apply for relief.

The scope of the *Vanston* rule is shown by this Court's later decision in *Fleming* v. *Traphagen*, 329 U. S. 686 (1946) reh. den. 329 U. S. 832 (1947), in which the Court, on the authority of the *Vanston* case, reversed a holding of the Circuit Court of Appeals for the Seventh Circuit which had allowed interest upon interest.** The bonds in the *Fleming* case were fully secured; the income from the division of the debtor railroad securing the bonds exceeded the amount required for the payment of interest during the extended

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* Committee Petition, p. 9; Manufacturers Petition, p. 52.

** 155 F. (2d) 889 (C. C. A. 7th 1946).

period of delay caused by the Section 77 proceeding; and the Circuit Court of Appeals had held that the applicable State law entitled the bondholders to interest on interest. This Court nevertheless reversed the lower court's allowance of such interest.

The respondents submit that the *Vanston* case is decisive of both of the questions here presented; that the rejection of the "judgment theory" by the court below was the only possible result consistent with the *Vanston* case; and that there is accordingly no occasion for the writs to issue.

B. The uniform practice of the courts, in computing claims in reorganization proceedings, is opposed to the "judgment theory".

In case after case, the District Courts, the Circuit Courts of Appeal and this Court, in computing the amount of creditors' claims to be paid or provided for in Chapter X and railroad reorganization plans, have proceeded in direct conflict with the petitioners' "judgment theory".

(i) Cases Relating to the Rate of Interest.

Before discussing the reorganization cases, the respondents wish to point out that the petitioners and the SEC are in error in assuming that their "judgment theory" is followed in straight bankruptcy. By making this assumption the petitioners are able to frame a question-begging issue for this Court of whether creditors' rights are less under Chapter X than in straight bankruptcy.* But the courts have not—even in straight bankruptcy— followed the "judgment theory" asserted by the petitioners.

The bankruptcy courts have, for example, in those cases in which interest after the petition was payable, given effect

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* SEC Brief, pp. 2, 7-12; Committee Petition, pp. 8, 16; Manufacturers Petition, p. 10; Vanneck Petition, p. 4.

to the contract as to the rate of interest payable for the period of the bankruptcy proceeding. In one of the principal bankruptcy cases establishing the doctrine that interest is to be paid on principal where a secured creditor's security is sufficient (or where the bankrupt is solvent), *Coder* v. *Arts*, 213 U. S. 223, 245 (1909), this Court affirmed a decision which had allowed the payment of interest during the period of bankruptcy at the contract rate "*in accordance with the terms of the note and mortgage*".* See also 3 COLLIER, BANKRUPTCY (14th ed. 1941), pp. 1839, 1844, to the effect that, if a bankrupt proves to be solvent, interest will be allowed during the proceeding "*at the rate contracted for*" up to the date of payment. The petitioners' contention that the Circuit Court's decision in this *Realty Associates* case gives creditors "less substantive rights" in Chapter X than in straight bankruptcy is thus demonstrably incorrect as to the rate of interest point.

The Circuit Court, however, limited its rejection of the petitioners' "judgment theory" to reorganization cases (reserving decision on whether the "judgment theory" would warrant departure from the contract rate of interest in a straight bankruptcy case); as shown below, the reorganization precedents are uniformly consistent with the decision of the Circuit Court.

In the Section 77 case of *Ecker* v. *Western Pacific Railroad Corp.*, 318 U. S. 448 (1943), the computation of the claims set forth in the opinion of this Court demonstrates that claims are not treated as "judgments", but are to be computed (with respect to the period after, as well as before, the reorganization petition) in accordance with the provisions of the contract.

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* *Coder* v. *Arts*, 152 Fed. 943, at 950 (C. C. A. 8th 1907). Emphasis supplied throughout this brief, unless otherwise noted.

The *Western Pacific* reorganization began with the filing of the debtor's petition on August 2, 1935. Interest installments on the Western Pacific's First Mortgage Bonds had matured and remained unpaid for almost a year and a half before the start of the proceeding. If there were any validity to the "judgment theory", then the First Mortgage Bondholders should have been allowed interest after the date of the petition at the legal rate, and such allowance should have included legal interest not only on the principal, but also on all of the accrued interest which was due and unpaid at the date of the petition. But this was not done. Instead, the First Mortgage Bondholders' claim was allowed for the principal amount of the bonds plus "Accrued interest at contract rate to effective date of plan" on principal only (318 U. S. 448, at p. 455). Thus the interest was computed at the 5% rate provided for in the contract; it was not computed at the 6% legal rate which would have had to be applied if there were any such rule of law as the "judgment theory".

In *Brooks* v. *St. Louis-San Francisco Railway Co.*, 153 Fed. (2d) 312 (C. C. A. 8th 1946) cert. den. 328 U. S. 867 (1946), the argument was advanced to the Court that certain secured bondholders were not entitled to any interest from the time of the initiation of the reorganization proceedings. The Court quite properly held that the bondholders were entitled to such interest as a matter of right and that the rate of interest to which they were entitled was the contract rate. The Court said (p. 318):

> "Interest on secured claims to the effective date of the plan is entitled to the same priority as the principal. *Consolidated Rock Products Co.* v. *DuBois, supra; Ecker* v. *Western Pacific R. Corporation, supra; Case* v. *Los Angeles Lumber Products Co., supra; Louisville Joint Stock Land Bank* v. *Radford,*

> 295 U. S. 555, 55 S. Ct. 854, 79 L. Ed. 1593, 97 A. L. R. 1106; *American Iron & Steel Mfg. Co.* v. *Seaboard Air Line Railway*, 233 U. S. 261, 34 S. Ct. 502, 58 L. Ed. 949; *Group of Investors* v. *Milwaukee R. Co.*, *supra*. The time as of which the claims of creditors should be computed was fixed as January 1, 1944 [the effective date of the plan of reorganization]. From that time the interest on the securities will be the new rate, *but up to that time it will be computed on the old securities at the contract rate.* This determination, we think, is reasonable and equitable and violative of no legal principle."

As shown in the appendix to this brief, in the computation of claims in numerous other railroad reorganizations in which various bond issues matured during the proceedings, the interest that was allowed for the period of the proceedings, both before and after the maturity of the bonds, was at the contract rate. *Chicago, Rock Island & Pacific Railway Reorganization*, 257 I. C. C. 307 (1944); 157 F. (2d) 241 (C. C. A. 7th 1946); *Missouri Pacific Railroad Reorganization*, 257 I. C. C. 479 (1944); 64 F. Supp. 64 (E. D. Mo. 1945); *Minneapolis, St. Paul & Sault Ste. Marie Railway Company Reorganization*, 252 I. C. C. 525 (1942); 48 F. Supp. 330 (Minn. 1942); *Chicago, Milwaukee, St. Paul & Pacific Railroad Company Reorganization*, 254 I. C. C. 707 (1943); 145 Fed. (2d) 299 (C. C. A. 7th 1944).

This same practice has also been followed in Chapter X proceedings. For example, this was done in the reorganization proceeding relating to *McKesson & Robbins, Inc.* in the Southern District of New York. The computation of claims in this proceeding is shown by the report of the SEC on the proposed plan of reorganization* and the SEC took a position there totally inconsistent with the

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* 8 S. E. C. 853 (1941).

"judgment theory" as it approved of a plan that provided for the contract, not the legal rate of interest. The SEC said in its report (8 S. E. C. 853 at 876):

> "The plan provides that creditors shall receive all accrued interest in cash. The rate of interest on the several claims is the legal rate *where there is no contract rate.* Thus, with respect to the debentures (item 2) interest on principal and on overdue installments of interest is computed at the rate of 5½% *in accordance with the provisions of the indenture under which the debentures were issued.*"*

Another Chapter X example is *In re Adolf Gobel, Inc.* (Bankruptcy No. 79,526, S. D. N. Y., 1944), the relevant facts being set forth in the appendix to this brief; the plan, as approved and confirmed, provided for continuation of the 4½% contract rate of interest on debentures throughout the proceeding although the bonds had matured by their terms prior to the start of the proceeding.

The significance of this continued recognition of the contract rate of interest in these reorganization cases is clear. Allowed claims of senior creditors must include all interest to which they are entitled down to the effective date of the plan of reorganization if any junior interests are allowed to participate; otherwise the treatment accorded such senior creditors is not "fair and equitable." *Consolidated Rock Products Co.* v. *DuBois* (*supra*, p. 10); *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Co.* (*supra*, pp. 10-11). If there were a rule of law such as the "judgment theory" entitling bondholders, irrespective of the provisions of their contract, to the legal rate

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* As the *McKesson* reorganization was consummated before this Court's decision in the *Vanston* case, an express contractual provision for interest on interest was given effect in accordance with the SEC's recommendation.

of interest from the date of the petition (or from the maturity of their bonds) then the reorganization plans in all of the above-discussed cases would, to the extent that junior interests were allowed to participate, violate the "absolute priority" rule as set out in the *Consolidated Rock Products* and *Milwaukee* cases. That the reorganization plans in these cases have been held to be "fair and equitable" demonstrates the absence of any rule of law such as the "judgment theory" which would entitle senior creditors to greater rights than they were accorded.

The petitioners and the SEC seek to avoid conflict with the above cited precedents and to justify their position in this *Realty Associates* case by saying that they would apply the "judgment theory" to change from the contract rate to the legal rate only as at the "normal" maturity date of the bonds and suggest that judgment rights in this respect are not to be extended to a creditor if his claim does not reach "normal" maturity during the pendency of the proceeding; in such case the petitioners and the SEC would give the creditor only contract interest throughout the proceeding.* The petitioners thus concede (after considerable argument that the "judgment" rights of creditors stem from Section 63(a)(1) of Bankruptcy Act "at the date of the petition"**) that the Act itself does not give a creditor "judgment rights" to the legal rate. The petitioners necessarily abandon their position that the statute makes "judgment rights" mandatory when they take the totally inconsistent position that there are no such rights until "normal maturity". And the petitioners ignore that, in the *Gobel* case (*supra*, p. 17), the bonds matured before the proceeding and in *Coder* v. *Arts* (*supra*, p. 14), and in

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* SEC Brief, p. 17, n. 19; Manufacturers Petition, p. 40n.; Vanneck Petition, pp. 6-7.

** SEC Brief, pp. 8-14.

the *Rock Island, Missouri Pacific, Minneapolis-St. Paul* and *Milwaukee* cases (*supra*, p. 16) the claims reached their "normal maturity date" during the proceedings and that the contract rates of interest were nevertheless applied to the period after maturity as well as before.

The SEC attempts to escape this dilemma by saying that some of the cases cited above involve claims whose "normal" maturity dates did not arrive until "well after" the petition for reorganization;* while the petitioners suggest that in this *Realty Associates* case the three-day interval between the filing of the petition and the due date of both the principal and the interest on the bonds is "inconsequential".** But Chapter X permits the filing of a petition in contemplation of an approaching maturity, and complete uncertainty would be introduced into Chapter X proceedings if the change from the contract rate to the legal rate were made dependent upon the length of the interval between the date of the petition and the maturity of the debt.

(ii) Cases Relating to Interest on Interest.

Despite the petitioners' assertions that their "judgment theory" is a well-established rule, they have not cited a single case under Chapter X or Section 77 or Section 77B requiring the payment of interest on interest accrued to or payable at the date of the petition. In fact, quite apart from the *Vanston* case, which is a square holding against the allowance of interest on interest in a Chapter X proceeding, the reorganization cases have not allowed interest on interest where, as here, there was no contract right to it. This Court, in *Ecker* v. *Western Pacific Railroad Corp.*, referred to above (pp. 14-15), had before it a claim which

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* SEC Brief, p. 17.

** Committee Petition, p. 4.

included bond interest installments matured and payable prior to the inception of the reorganization proceeding. The computation of the bondholders' claim did not include any interest on such interest.

In both the *Chicago, Rock Island and Pacific Railway Reorganization* (*supra,* p. 16), and the *Missouri Pacific Railroad Reorganization* (*supra,* p. 16), the bond issues matured during the proceeding and interest was in default for a period of years before the maturity date of the principal. In the computation of the claims of the holders of these bonds, no interest was allowed on such interest.* And in *In re Norcor Mfg. Co.,* 36 F. Supp. 978 (E. D. Wis. 1941) and *In re Wisconsin Central Railway Co.,* 63 F. Supp. 151 (D. Minn. 1945) creditors' claims for interest on interest were also denied. The same result was reached in *In re Adolf Gobel, Inc.* (Bankruptcy No. 79,526, S. D. N. Y. 1944).*

C. The cases cited by the petitioners do not support their theory and there is no conflict in any of the Circuit Courts of Appeals.

The cases cited by the petitioners do not support their theory. The Circuit Court (R. 214) rejected the application which the petitioners would make of *In re John Osborn's Sons & Co.,* 177 Fed. 184 (C. C. A. 2d 1910).** In the *Osborn* case, the Circuit Court did not have before it, as it did here, a case in which the application of the "judgment theory" would change the rate of interest from that provided for by the parties' agreement; and the *Osborn* case did not involve any question of interest on interest.

The SEC and the petitioners give the impression that in *Johnson* v. *Norris,* 190 Fed. 459 (C. C. A. 5th 1911) interest

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* Data showing the computation of claims in these cases is set forth in the appendix to this brief.

** Committee Petition, p. 16; Manufacturers Petition, p. 19; Vanneck Petition, p. 10; SEC Brief, p. 8.

was allowed on interest.* But this is not so. A study of the record of that case shows that the problem of interest on interest was not before the Court.** And a study of the opinion shows that, although the "judgment theory" was argued and the Court's attention was directed to the *Osborn* case and *National Bank of the Commonwealth* v. *Mechanics' National Bank,* 94 U. S. 437 (1876), the Court refused to base the allowance of simple interest on principal on any ground so mechanical as the "judgment theory", but instead based the allowance upon its general equitable powers. The Court also noted, contrary to the petitioners' position here, that there was nothing in the Bankruptcy Act relating to the problem of post-petition interest in bankruptcy proceedings. Thus, *Johnson* v. *Norris* does not present a "conflict" with the decision below, as contended by one of the petitioners***, but, like the decision below, actually rejected the "judgment theory".

The facts in the *Mechanics' National Bank* case (*supra*) make it apparent that it has no application to the *Realty*

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* The SEC Brief says (p. 9): "Thus, in *Johnson* v. *Norris,* 190 Fed. 459 (1911), the Fifth Circuit Court of Appeals ruled that interest was payable on claims which, as filed, included interest accrued prior to the date of the bankruptcy petition, before any part of a surplus held by the trustee could be turned over to the bankrupt."

** At page 10 of the Record on Appeal in *Johnson* v. *Norris* the question which had been certified by the Referee and which was before the Circuit Court is set forth as follows:

> "Are creditors who have been paid in full *the amount of claims* filed against the bankrupt estate, *together with interest thereon up to the date of the filing of the petition in bankruptcy,* also entitled to collect out of said estate *interest on their claims* from the date of the filing of the petition in said bankruptcy up to the time of payment in full of said claims?"

The language in the quotation shows that the word "claims" referred only to the principal of the debt and that the interest thereon prior to the date of the petition in bankruptcy was not included in the term.

*** Manufacturers Petition, pp. 30-31.

Associates situation. In the *Mechanics'* case, certain bank depositors demanded payment of their deposits on September 24, 1873, but the bank failed to pay. On November 22, 1873, the Comptroller of Currency appointed a receiver for the bank and such receiver made four different payments on account of principal owed to the bank's depositors. At the time of each such principal payment, demand was made by the depositors for the payment of interest thereon from September 24, 1873. Each of the four demands for interest was rejected by the receiver, the final rejection being at the time of the final principal payment on November 20, 1874. Suit was then brought by the depositors for the aggregate of all rejected interest claims and interest thereon from November 20, 1874, the date of the final rejection, and that is what the Court allowed. The Court did not treat the claimants as judgment creditors as of the start of the receivership, but held that the final rejection of the claims could, under those facts, be treated as a judgment.

The *Mechanics'* case would be apposite in this *Realty Associates* case only if District Judge Moscowitz, in computing the bondholders' claims in his order of April 2, 1945, dismissing the proceeding, had denied to the bondholders any interest on the principal of their bonds after maturity. If Judge Moscowitz had made such a determination, it would have been error, the reversal of which would have justified the reviewing court, on the authority of the *Mechanics'* case, in instructing the payment not only of the interest on principal which accrued during the proceeding, but also interest on that interest from and after April 2, 1945.

In re New York, New Haven & Hartford R. Co., 147 F. (2d) 40 (C. C. A. 2d 1945), cited by the petitioners,* in

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* SEC Brief, pp. 15-16; Vanneck Petition, p. 9.

no way supports them. The question there presented was whether creditors who were almost fully secured at the start of the proceeding, but whose security became worthless during the Section 77 restraint on foreclosure, should be treated as unsecured creditors. As shown below (p. 27) the Realty Associates bondholders, unlike the *New Haven* secured creditors, have not in fact sustained any loss as a result of the proceeding; further, the application which the petitioners would make of the *New Haven* case would be in conflict with the *Vanston* case.

The other cases cited by the petitioners and the SEC are likewise inapposite. For example, *Bindseil* v. *Liberty Trust Co.*, 248 Fed. 112 (C. C. A. 3rd 1917)—cited in the Manufacturers Petition (p. 32) as presenting a "conflict" with the decision below—dealt only with the right of a mortgagee to have rents from property subject to the mortgage applied to the mortgage debt as against the claims of the bankrupt's general creditors. The case had nothing to do with any problem of the computation of interest.*

The petitioners and the SEC have not cited a single Chapter X, Section 77B, Section 77 or bankruptcy case in which the "judgment theory" or any other theory was given effect to apply the legal rate to the post-petition or post-maturity period in disregard of the applicable contract rate; and not one of their briefs refers to a single Circuit Court Chapter X, Section 77B, Section 77 or bankruptcy case which allowed interest on interest.**

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* The same is true of the other cases cited in the SEC Brief (p. 16, footnote 15) with the *Bindseil* case.

** Manufacturers Petition (pp. 12-13, 22n.) cites as authority for allowing interest on interest two recent unreported decisions in Chapter X proceedings in the Southern District of New York relating to *Childs Company* and *United States Realty & Improvement Company* (in neither of which there was an opinion). It is sufficient to say here that both such decisions were made prior to this Court's decision in the *Vanston* case.

D. The construction of the Bankruptcy Act is not involved and the "judgment theory" is contrary to the purpose of Chapter X.

Some of the petitioners urge that a construction of the Bankruptcy Act is involved and suggest that support for their view is to be found in Section 63(a)(1) of the Bankruptcy Act.* But it is this very section of the Bankruptcy Act which expressly cuts off the accrual of interest in bankruptcy at the date of the bankruptcy petition so that no interest runs during the proceeding.** So far as Section 63(a)(1) is concerned, interest stops as of the date of the petition; the bondholders cannot obtain any authority for their position from its provisions. In cases in which the bankrupt or debtor is solvent (or a secured creditor's security is sufficient) the courts have held that the obligation to pay interest "revives" (See 3 COLLIER, BANKRUPTCY, 14th Ed., p. 1838) and that interest runs on principal during the proceeding, but this is an equitable rule developed by the courts; it is not based on statute. Neither Section 63(a)(1) nor any other section is involved in the questions here presented.

The suggestion in the SEC Brief (p. 11) that the decision below creates problems under Section 238 (1) in the event that a Chapter X proceeding is converted into a straight bankruptcy liquidation is negated for two reasons: first, the SEC assumes, mistakenly as shown above (pp. 13-14), that in straight bankruptcy the bondholders would have been entitled under the "judgment theory" to the legal rate of interest and to interest on interest; second, conversions from Chapter X to straight bankruptcy occur in cases in which the debtor is insolvent and, in such cases,

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* 11 U. S. C. §103(a)(1).

** *Sexton* v. *Dreyfus*, 219 U. S. 339 (1911); 3 COLLIER, BANKRUPTCY (14th ed. 1941) p. 1835, *et seq.*

the creditors are denied, not only "judgment interest", but any post-petition interest at all. If the debtor is solvent or if secured claims are involved, the computation of interest, under the principles so recently reviewed by this Court in the *Vanston* case, would hardly present "difficulties" such as the SEC fears.

The application of petitioners' "judgment theory" would, moreover, contravene the purpose of Chapter X, which contemplates a continuation of the business of the debtor, a continuation of the contractual relationships between the debtor and its creditors, and a stay of the normal creditors' remedies until a plan of reorganization is evolved which is fair to all interested parties. As was aptly said by the SEC itself several years ago:*

> "Reorganization is not bankruptcy and becomes such only if an order of liquidation is entered. The estate is not a 'dead fund'; its status as a going concern is maintained until a plan of reorganization can be worked out. We submit that while the business continues as a living enterprise, substantial justice can be worked only by a rule which continues the contract rights of the parties so far as possible as they existed before the enterprise came under judicial control; that is, by the accrual of interest on the debts until the cut-off date under the plan."

To apply the "judgment theory" so as to disregard the contract between the debtor and its creditors and arbitrarily allow interest at the legal rate from the date of a Chapter X petition (or from the maturity date of bonds) and to allow interest on interest would be to deny to debtors the relief that Congress provided for them in Chapter X.

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* In the "Memorandum of the Securities and Exchange Commission, Supplementing its Advisory Report, in Support of Accrual of Interest During Reorganization Proceedings," which the SEC submitted to the Court in a Chapter X proceeding, *In re Minnesota and Ontario Paper Company*, 7 S. E. C. 456 (1940); S. E. C. Corporate Reorganization Release No. 33 (pp. 8-9) (August 1, 1940).

Interest upon a judgment is allowed as damages for unwarranted delay in payment. But Congress, by enacting Chapter X, has expressly authorized delay in the payment of a debt in certain cases—cases in which a petition is filed, in good faith, by a debtor unable to meet its debts as they mature. Such delay is authorized for the benefit and protection of creditors as well as the debtor, for all creditors might suffer if they were free to obtain judgments, levy executions and force the immediate sale of a debtor's assets at depressed values. Congress recognized that the interests of creditors and the debtor lay in the preservation of the business as a going concern and the orderly adjustment of the claims of creditors under the supervision of the Court in accordance with the principles laid down in the statute.

The bondholders in this *Realty Associates* case were stayed from bringing suit at the maturity of their bonds and thus forcing an immediate liquidation. But the necessity for such a stay, if the bondholders were to be paid in full and the purpose for which Congress enacted Chapter X thus achieved, is shown by the following statement of the District Court (in its unreported opinion deciding that the petition in this *Realty Associates* case was filed in good faith):

> "Now, of course, if this were not a procedure under Chapter X, if it went into bankruptcy and judgments piled up against the debtor on these bonds that become due on October 1st, and with the debtor here a straight bankrupt, it would wipe out these assets and the creditors would probably realize very little. It would be calamitous—yes, calamitous unless this corporation and the creditors who came first were afforded protection under the law, and I can think of no greater disservice by court or by counsel to creditors than not to give them the protection and benefit of this law."

Statements in the SEC Brief (pp. 3 and 16) regarding the Debtor's Chapter X petition give an erroneous impression that the Debtor sought relief under Chapter X solely to protect itself. As the petition shows, relief was sought "for the protection of creditors and stockholders" (R. 6-7) and, as the District Judge found when ruling upon the petition, the proceeding was filed in good faith and was necessary for the protection of creditors as well as the Debtor.

The bondholders were not damaged by the proceedings thus instituted for the benefit of all; under Chapter X, they realized their full claim with interest on principal to the date of payment, a result which (as pointed out by the District Court) would have been unlikely if the bondholders had been allowed to sue for and enforce judgments at the maturity of the bonds. Contrary to one petitioner's assertion that the Debtor realized "vast income" during the proceedings,* the earnings of the Debtor during the entire period of the Chapter X proceedings amounted to $302,216.35 (R. 144)—less than enough to pay the 5% contract rate of interest on principal which was paid to the bondholders. To now treat the bondholders as "judgment creditors" from the date of the petition (or from the maturity date of their bonds) so that they can obtain added compensation for the delay would be inconsistent with the provisions of Chapter X which authorized the delay for the benefit of all concerned.

Both the theory of Chapter X and the realties of this case dispose of the petitioners' argument that the bondholders have sustained any loss of "substantive rights" as a result of the decision below.

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* Manufacturers Petition, p. 4.

2. The construction of the contract by the Court below does not warrant review.

The Court below, having rejected the "judgment theory", held that the contract rate of interest ran during the proceedings and found that the contract here involved, when construed under the applicable New York law, provided for an interest rate of 5% after maturity. Such a decision does not call for review by this Court.

Article VI of the Debtor's 1933 Indenture provides that, upon the happening of various events of default (including the start of insolvency proceedings or non-payment at maturity) the moneys recovered by the Indenture Trustee in legal proceedings shall be applied to payment of principal and interest, *"with interest at the rate of five per cent. (5%) per annum on the overdue principal"* (R. 120). This provision leaves no doubt that the parties intended that the 5% rate should apply after a defaulted maturity date. The Circuit Court thus gave the contract the only construction which would be consistent with the intention of the parties.

The bondholders' contract with the Debtor does not provide for the payment of interest on interest; neither the 1933 Indenture nor the bonds provide for such payment. Thus the decision below is entirely consistent with the views expressed in the concurring opinion written by Mr. Justice Frankfurter in the *Vanston* case, as well as with the majority opinion in that case.

Even if the bondholders' contract expressly provided for interest on interest, it would appear from the applicable New York cases that the bondholders could not recover interest upon interest. The New York cases hold that, as a matter of law, interest is not payable upon interest.

Young v. *Hill*, 67 N. Y. 162 (1876); *Newburger-Morris Co.* v. *Talcott*, 219 N. Y. 505, 114 N. E. 846 (1916); *Continental Securities Company* v. *New York Central & H. R. R.*, 217 N. Y. 119, 111 N. E. 484 (1916); *Transbel Investment Co.* v. *Roth*, 36 F. Supp. 396 (S. D. N. Y., 1940).*

The opinion of the Court below shows, however, that its decision was not based on this New York policy against interest on interest as suggested by the SEC.** The Court rejected the claim to interest on interest on the authority of the *Vanston* case (R. 217), which is applicable with even greater force to the *Realty Associates* bonds which did not provide for interest on interest.

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* There is an exception, not material here, to such rule. If interest coupons have been negotiated separately from the bonds, interest on such coupons may be recovered. *Williamsburgh Savings Bank* v. *Solon*, 136 N. Y. 465, 32 N. E. 1058 (1893); *Long Island L. & T. Co.* v. *Long Island City & N. R. R. Co.*, 85 App. Div. 36 (2d Dept. 1903), aff'd 178 N. Y. 588 (1904).

** SEC Brief, p. 14.

Conclusion.

Each of the petitions for a writ of certiorari should be denied.

Dated, November 17, 1947.

Respectfully submitted,

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Appendix.

Data Showing Computation of Claims in Various Reorganization Cases Cited in the Foregoing Brief (pp. 16-17, 20).

1. *Chicago, Rock Island & Pacific Railway Company Reorganization,* 257 I. C. C. 307 (1944). The plan was approved by a District Court in 1945 and such approval was affirmed in 157 F. (2d) 241 (C. C. A. 7th, 1946). The reorganization petition was filed on June 7, 1933 and the effective date of the plan was January 1, 1944.

   (a) The claim of holders of *Rock Island, Arkansas & Louisiana First Mortgage 4½s, due 1934* was computed as follows:*

(i) Total claim of bondholders for principal (257 I. C. C. 318).....	$11,000,000
(ii) Total claim of bondholders allowed for interest (257 I. C. C. 339)	5,362,500
(iii) Total claim of bondholders for principal and interest as of January 1, 1944 (257 I. C. C. 318)....	$16,362,500

Interest was owing on these bonds from March 1, 1933 (see Moody's *Railroads,* 1943, p. 519) down to January 1, 1944 (the effective date of the plan), which is a period of 10 years and 10 months. 4½% interest on the $11,000,000 principal for 10 years and 10 months is precisely the amount of interest allowed in the claim..... $ 5,362,500

* The claim in this *Rock Island* proceeding of the holders of *The Chicago, Rock Island & Pacific First and Refunding Mortgage 4% bonds due 1934* was computed in the same manner as this issue (see 257 I. C. C. 318, 338). Details as to such claim are not given as they would merely be cumulative.

(b) The claim of holders of *Burlington, Cedar Rapids & Northern Consolidated First Mortgage 5s, due 1934* was computed as follows:

(i) Total claim of bondholders for principal (257 I. C. C. 318).....	$11,000,000
(ii) Total claim of bondholders allowed for interest (257 I. C. C. 339)	5,912,500
(iii) Total claim of bondholders for principal and interest as of January 1, 1944 (257 I. C. C. 318)....	$16,912,500
Interest was owing on these bonds from April 1, 1933 (see Moody's *Railroads,* 1943, p. 513) down to January 1, 1944 (the effective date of the plan), which is a period of 10 years and 9 months. 5% interest on the $11,000,000 principal for 10 years and 9 months is precisely the amount of interest allowed in the claim.....	$ 5,912,500

2. *Missouri Pacific Railroad Reorganization,* 257 I. C. C. 479 (1944). The plan was approved by the District Court in 64 F. Supp. 64 (E. D. Mo. 1945). The reorganization petition was filed in 1933 and the effective date of the plan was January 1, 1943.

The holder of each $1000 *Little Rock & Hot Springs Western First 4% Bond* which matured in 1939 was allowed for his interest claim (257 I. C. C. 569).....	$ 320
Interest was owing on these bonds from January 1, 1935 (see Moody's *Railroads,* 1944, p. 948) down to January 1, 1943 (the effective date of the plan)—a period of 8 years. Interest at the rate of 4% on $1000 for 8 years is	$ 320

3. *Minneapolis, St. Paul & Sault Ste. Marie Railway Company Reorganization,* 252 I. C. C. 525 (1942). The plan

was approved by the District Court in 1942, 48 F. Supp. 330 (Minn., 1942). The petition was filed in 1937 and the effective date of the plan was January 1, 1941.

The table of claims (252 I. C. C. 581) shows that the interest rates specified in the bonds were used in computing the "Amount of claim and interest to January 1, 1941" (the effective date of the plan). This is easily demonstrated by considering in such table the claim of the unguaranteed *First Consolidated Mortgage 5% Bonds* which matured on July 1, 1938:*

Principal of claim	$ 6,148,000
"Interest matured Jan. 1, 1938, to Jan. 1, 1941 inclusive" allowed in the claim	$ 1,075,900

It can be seen that the interest in the claim was for a period of 3½ years (the Jan. 1, 1938 coupon covered the 6 months back to July 1, 1937). One year of this 3½ years was prior to the maturity of the bonds and 2½ years were after maturity. 5% interest on the $6,148,000 principal for 3½ years is precisely the amount of interest allowed in the claim $ 1,075,900

4. *Chicago, Milwaukee, St. Paul & Pacific Railroad Company Reorganization*, 254 I. C. C. 707 (1943). Approved 58 F. Supp. 384 (N. D. Ill., 1944), appeals dismissed 145 F. (2d) 299 (C. C. A. 7th, 1944). The petition was filed in 1935 and the effective date of the plan was January 1, 1944.

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* As recited in the table, the contract rates of interest (4% as to some bonds and 5% as to others) were also used in computing the claim of the First Consolidated Mortgage bonds which were guaranteed as to interest by the Canadian Pacific Railway. Because of certain minor adjustments not here material, calculation of the interest on these bonds cannot be made solely from the figures furnished in the table at 352 I. C. C. 581.

(a) The claim of the holders of *Milwaukee & Northern First 4½% Bonds* which matured in 1939 was computed as follows:

(i) Total claim of bondholders for principal (254 I. C. C. 739).....	$ 2,117,000
(ii) Total claim of bondholders allowed for interest from January 1, 1939 to January 1, 1944 (254 I. C. C. 713).....	$ 476,325
Interest was owing on these bonds from January 1, 1939 to January 1, 1944 (the effective date of the plan), which is a period of 5 years. 4½% interest on the $2,117,000 principal for 5 years is precisely the amount of interest allowed in the claim*.....	$ 476,325

(b) The claim of the holders of *Milwaukee & Northern Consolidated 4½% Bonds* which matured in 1939 was computed as follows:

(i) Total claim of bondholders for principal (254 I. C. C. 739).....	$ 5,072,000
(ii) Total claim of bondholders allowed for interest from January 1, 1939 to January 1, 1944 (254 I. C. C. 713).....	$ 1,141,200
Interest was owing on these bonds from January 1, 1939 to January 1, 1944 (the effective date of the plan), which is a period of 5 years. 4½% interest on the $5,072,000 principal for 5 years is precisely the amount of interest allowed in the claim*.....	$ 1,141,200

* See, also, 254 I. C. C. 707, at p. 712, where the Commission says that the interest on these bonds for the period from January 1, 1939 to January 1, 1944 was to be paid in cash "*at the rates named in the bonds*".

5. *In re Adolf Gobel, Inc.* (Bankruptcy No. 79,526, S. D. N. Y.; plan approved on June 1, 1944 and confirmed on July 31, 1944, by Judge Coxe). The Chapter X petition was filed on September 29, 1941 and the effective date of the plan of reorganization was October 16, 1944.

The debtor had outstanding $1,081,000 principal amount of 4½% Convertible Debentures which had matured in normal course on May 1, 1941 (before the start of the Chapter X proceeding). At the start of the proceeding, interest for the five months' period after the maturity of the Debentures was also unpaid. The common stockholders' participation in the debtor was continued (without their putting up any funds). Public bondholders holding $358,000 principal amount of the Debentures, were paid in cash under the reorganization plan "the principal amount of the $358,000 of Old Debentures * * * with interest on said principal at the rate of 4½% per annum from May 1, 1941 to October 16, 1944." (See Judge Coxe's Order in Aid of Consummation of the Plan of Reorganization dated October 6, 1944, in the Court file in the proceeding.)*

* The remaining $723,000 principal amount of Debentures plus interest at 4½% to October 16, 1944 were surrendered for new securities.